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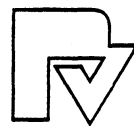
# Ukraine's WTO Accession

Challenge  
for Domestic  
Economic  
Reforms



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# **Ukraine's WTO Accession: Challenge for Domestic Economic Reforms**



Ihor Burakovsky

Lars Handrich

Lutz Hoffmann

Editors

# **Ukraine's WTO Accession: Challenge for Domestic Economic Reforms**

With 33 Figures  
and 35 Tables

Springer-Verlag Berlin Heidelberg GmbH

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# Acknowledgments

Nine months ago, the Institute for Economic Research and Policy Consulting and the German Advisory Group on Economic Reforms with the Ukrainian Government hosted the international conference “Ukraine’s WTO Accession: Challenge for Domestic Economic Reforms” in Kyiv to provide a forum for the exchange of ideas and evidence on the accession of Ukraine to the WTO and the implications for policy-making. Ukrainian policy-makers, WTO officials, and international experts representing a wide variety of different countries and institutions were invited to present their views.

This book is a compilation of the presentations made at that conference. The book, published in Ukrainian and English languages, discusses many aspects of Ukraine’s accession to the WTO and implications of WTO membership afterwards.

As the editors of this book we would like to express our thanks first and foremost to the Ukrainian Government, President’s Office, the Parliament and National Bank of Ukraine.

In almost nine years of open, constructive dialog, we have built a relationship based on trust that serves as a constant source of motivation. This trust and dialog is a prerequisite for the mutual exchange of questions and answers without which the work we do in Ukraine would be in vain.

We would also like to thank the authors who have contributed to this book and who travelled to Kyiv from many corners of the world to present, debate and discuss their thoughts with Ukrainian policy-makers, colleagues, and students.

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## VI

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Ihor Burakovsky (Kyiv)   Lars Handrich (Berlin)   Lutz Hoffmann (Regensburg)

September 2003

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## Abbreviations

AMS	Aggregate Measure of Support
BEEPS	Business Environment and Enterprise Performance Survey
CAP	Common Agricultural Policy
CCP	Counter-Cyclical Payments
CEEC	Central and Eastern European Countries
CEFTA	Central European Free Trade Agreement
CEPR	Center for Economic Policy Research
CIS	Commonwealth of Independent States
CIT	Countries in Transition
COMECON	Council for Mutual Economic Aid
CPER	Center for Privatisation and Economic Reform in Agriculture
CU	Customs Union
EBRD	European Bank for Reconstruction and Development
EFTA	European Free Trade Association
ERAD	Economic Research and Analysis Division (WTO)
EU	European Union
EUR	Euro
FAIR	Federal Agriculture Improvement and Reform
FDI	Foreign direct investment
FSRI	Farm Security and Rural Investment
FTA	Free Trade Agreements
FYR	Former Yugoslav Republic (Macedonia)
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GOU	Government of Ukraine
GTAP	Global Trade and Analysis Project
IBRD	International Bank for Reconstruction and Development
IGC	International Grains Council
IIPA	International Intellectual Property Alliance
IMF	International Monetary Fund
IPR	intellectual property rights
IRIS	Center for Institutional Reform and the Informal Sector
KC	Czech crown (currency)
MEA	Multilateral Environmental Agreements
MFN	most-favored-nation
MTR	Mid-Term Review
NAFTA	North American Free Trade Agreement
NIS	New Independent States
NME	Non-Member Economies

#### XIV

OECD	Organisation for Economic Cooperation and Development
PDR	People's Democratic Republic (Lao)
PSE	Producer Support Estimate
RTA	Regional Trade Agreement
S&D	Special and Differential Treatment
SOE	State Owned Enterprises
SPS	Agreement on Sanitary and Phyto-Sanitary
TACIS	Technical Assistance to the Commonwealth of Independent States
TBT	Agreement on Technical Barriers to Trade
TPRM	Trade Policies Review Mechanism
TRIMs	Trade-related investment measures
TRIPS	Trade-related intellectual property rights
TRQ	tariff rate quota
UAH	Ukrainian Hryvnia
UEPLAC	Ukrainian-European Policy and Legal Advice Centre
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UR	Uruguay Round
URAA	Uruguay Round Agreement on Agriculture
US	United States
USA	United States of America
USD	US Dollar
USSR	Union of Soviet Socialist Republics
USTR	United States Trade Representative
VAT	Value-added tax
WB	World Bank
WIPO	World Intellectual Property Organisation
WTO	World Trade Organisation

# Introduction

**Lars Handrich**

**German Advisory Group on Economic Reforms with the Ukrainian Government**

## 1 Ukraine on the way to WTO membership

The first announcements by Ukraine to join the World Trade Organisation (WTO) were made in 1993. In the following year the Working group on Ukraine's accession was established. But successive Ukrainian governments had to sideline the issue of WTO accession, as the country went through a decade of unprecedented and severe economic decline.

Only in the year 2000 the Ukrainian economy started to achieve positive real economic growth. Since then Ukraine embarked on a stable path of economic growth and continues to grow even under conditions of a sluggish world economy and protectionist reflexes in some of Ukraine's export markets. According to the macroeconomic forecast of the Institute for Economic Research and Policy Consulting Ukrainian GDP will grow by 5,4% in 2003 in real terms and by 5,1% in 2004.<sup>1</sup>

For Ukraine WTO accession is of special importance. Ukraine records an extremely high exports-to-GDP ratio of over 60% - almost twice the ratio for Germany.<sup>2</sup> The large ratio and the little diversified structure of Ukraine's imports and exports make Ukraine seriously vulnerable to external shocks resulting from changes in trade regimes. Joining the WTO, trade among WTO members amounting to more than 90% of world trade, could reduce the risks related to external trade and Ukraine could derive substantial economic and hence welfare benefits from the membership in WTO.

Among the most important benefits are an improved market access for Ukrainian exporters and the dispute settlement mechanisms of WTO. At the same time membership could also lead to more credible government policies as regards the trade regime. As a WTO member, Ukraine would have to implement a set of

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<sup>1</sup> IER (2003): Macroeconomic Forecast Ukraine No. 1(2), April ([http://www.ier.kiev.ua/English/mfu\\_eng.cgi](http://www.ier.kiev.ua/English/mfu_eng.cgi)).

<sup>2</sup> IER (2002): Ukraine and the World Economy: Risk Assessment and Policy Recommendations, Kyiv, April ([http://www.ier.kiev.ua/English/books\\_eng.cgi](http://www.ier.kiev.ua/English/books_eng.cgi)).

norms, rules, and institutions resulting in more predictable, secure and transparent markets. Last but not least, Ukraine could participate in the future rounds of negotiations among the Members as regards rules constraining both formal trade and domestic regulation affecting trade.

The public discussion in Ukraine reveals that implications of WTO membership are often misunderstood. Arguments for delaying or even postponing the accession process wrongly anticipate an external shock coming with membership and sudden import competition. As regards import liberalisation the Ukrainian trade regime is already quite liberal, the tariffs charged are rather low in comparison e.g. with Russia<sup>3</sup>.

There are fears that accession would cause rapid adjustments of prices to world market levels, especially for input factors to production like energy. These sudden price hikes would not be sustainable for many Ukrainian producers, forcing too many to exit the markets. Some are even afraid, Ukraine being a young and vulnerable nation state is under danger being swept away by the tide of free trade and falling victim to powerful foreign interests.

Most of these fears are groundless, as WTO accession is not about free trade but trade liberalisation and the introduction of standards and rules for trade and trade related issues<sup>4</sup>. How gradual or radical this liberalisation process will be in Ukraine is to be negotiated with the present members.

But it is correct to state that Ukraine could derive most benefits from WTO membership by introducing market oriented reforms. Ukraine's often overly restrictive and non-market regulations are applied to domestic and foreign firms without partiality. Therefore these regulations are compliant with WTO rules. But the heavy regulatory burden hurts both, Ukrainian and foreign companies, and limits the potential economic benefits stemming from WTO membership.

Independently from the issue of WTO accession Ukraine should pursue market oriented structural reforms to increase the efficiency of its economy and develop the country.<sup>5</sup> But the combination of structural reforms and membership in WTO could amplify the benefits of the policies increasing the welfare of Ukraine and its citizens.

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<sup>3</sup> EBRD (2002): Transition Report. London.

<sup>4</sup> The World Trade Organization (WTO) describes itself on its website as "...the only global international organization dealing with the rules of trade between nations. At its heart are the WTO agreements, negotiated and signed by the bulk of the world's trading nations and ratified in their parliaments. The goal is to help producers of goods and services, exporters, and importers conduct their business". See [http://www.wto.org/english/thewto\\_e/whatis\\_e/whatis\\_e.htm](http://www.wto.org/english/thewto_e/whatis_e/whatis_e.htm).

<sup>5</sup> IER (2003): Development of Domestic Markets in Ukraine: Welfare through Competition. Kyiv, May.

## 2 Structure of the book

The growing Ukrainian economy provides the necessary room for maneuver for policy-makers to accelerate the important process of WTO accession. The current government of Prime Minister Victor Yanukovich has consequently put the issue of WTO accession on top of the political agenda. Equally important is the support of the issue in Parliament.

Part I of the book demonstrates the political commitments of the Ukrainian Government and Parliament, and includes statements by WTO officials.

*Mykola Azarov* stresses the fact that in Ukraine no one anymore seriously questions the usefulness of Ukraine's membership in WTO. Instead, the debate now focuses on more favourable conditions of accession (Chapter 1).

*Hector Millan* explains that the process of accession is of a country-specific nature (Chapter 2). Article XII of the Marrakesh agreement governing the rules of accession does not stipulate any membership criteria. Each accession is negotiated between WTO members and the applicant with is a typical economic situation. Consequently countries accede to the WTO on the terms agreed during the negotiations, which makes each accession unique.

*Valeriy Khoroshkovsky*, among the politicians committed most to Ukraine's WTO accession, puts the membership in an even wider European perspective (Chapter 3). WTO membership would admit Ukraine to the international economic community and serve as a recognised stamp of approval of proper policies. Furthermore, WTO membership would be a first but important step for Ukraine acquiring the status of an associated state of the European Union.

It is not justified to assume WTO will *force* new rules on Ukraine. But it is justified to say, as *Roger Lawrence* (Chapter 4) does, Ukraine would benefit most from the WTO membership by consequently pursuing market based economic reforms.

*Borys Tarasyuk* is concerned in Chapter 5 with the legislative process in Ukraine and the obvious inconsistencies of certain draft laws. Some important legislative changes necessary for WTO accession lack political support in parliament, while others are even breaching the standstill requirement with respect to the trade regime during the negotiation process.

*Yuriy Yekhanurov* argues in Chapter 6 in favour of quick accession, as it could help to overcome political inertia in Ukraine and speed up the process of structural market oriented reforms. Moreover, he stresses the importance of policies being consistent with WTO. However, reforms will not just happen through accession to WTO. Rather, the political will of Ukrainian policy-makers to consequently pursue structural reforms and introduce the necessary legislation will be necessary.

*Andriy Honcharuk* provides an overview on the state of negotiations between Ukraine and the members of Ukraine's working party. Some more detailed projections on important trade groups like metallurgy or agricultural produce give an impression of the extent of tariff reductions in the years ahead and the increase in trade it brings along.

*Ihor Burakovsky* summarizes the debate in Ukraine on WTO accession, the benefits such a step would deliver, and the implications the process will have for domestic policies.

In Part II of the book the implications of membership in WTO are assessed. *Klaus Günther Deutsch* sets a framework for analysis by raising important points concerning trade strategies related to WTO. In particular the trade strategy of Ukraine should be well considered before the accession. Deutsch argues in favour of a carefully set tariff structure, commensurate to Ukraine's level of development, industrialisation and capacity to cope with the social and economic effects of freer trade.

*Victor Ivanter, Marat Uziakov et al.* undertake in Chapter 10 the quite demanding attempt to quantify the impact WTO accession would have on Russia. They develop a concept of an *equivalent duty* (tariff), incorporating in the tariff structure the movements of the nominal exchange rate between the US Dollar and the Russian Rouble.

When Ukraine becomes a member of the WTO the country will have to implement a broad range of new domestic regulations and regulatory reforms. This will cost money and take time. In Chapter 11 *Philip Schuler* studies the administrative costs of implementing WTO rules governing intellectual property rights, industrial product standards, and food safety. The costs are estimated by referring to the experience of several larger middle-income developing countries. The costs of implementing new rules will be quite substantial, roughly the amount of current foreign aid to Ukraine. Ukraine would gain most from these investments if it would incorporate WTO obligations into general economic policy-making and develop the foundations of a market economy.

*Marc Bacchetta and Zdenek Drabek* draw conclusions from the recent experience of other transition countries joining WTO (Chapter 12). One conclusion - confirming the statement by *Hector Millan* in Chapter 2 - is the fact that each accession is unique and no precise blueprint of accession exists. Most acceding transition countries had liberal trade regimes in place already before accession. The costs of accession are not negligible, but despite the high "membership fee" the benefits are important. Among the most positive effects of accession to WTO experienced by transition countries are the reduction in corruption and improvements of governance.

Part III of the book deals with competition policy in the framework of WTO accession and membership. *Peter Holmes* argues that the issues of competition

policy related to WTO are already familiar to Ukraine from the agreement with the European Union. No additional disciplines created by any WTO agreement would be more binding than those the EU seeks to impose on Ukraine.

*Rüdiger Ahrend* addresses the extremely important issue of subsidization of industrial production through the energy sector, endemic to soviet style command economies. During Russia's WTO accession negotiations the EU raised the issue, as such subsidization would not be compatible with rules of competition in the context of WTO. Subsidies like cheap energy come at high economic efficiency cost discouraging structural adjustments and delaying market exit of non-viable firms. In case of net energy importing countries like Ukraine the reform of the energy sector is particularly urgent.

*Ihor Eremenko, Nadiya Mankovska, and James Dean* conclude from the results of their model that it does not support the notion that WTO membership will improve significantly the market access of Ukrainian exporters (Chapter 15). The model even states Ukraine already overtrades with its partners. Nevertheless, as regards Ukraine's US and EU trade, membership in WTO would mean switching from quotas to tariffs, which would be a substantial improvement of market access for Ukrainian exporters. Furthermore, a significant share of Ukrainian trade is directed towards CIS countries, most currently non-Members of WTO with rather restrictive trade regimes. As most CIS countries, including Russia, embarked on the way to WTO accession like Ukraine, it is safe to assume, that in the near future even in the CIS region more liberal trade regimes will emerge, meaning improved market access as well.

In Part IV of the book, dedicated to agricultural policy, *Yuriy Luzan* picks up again the importance of improved market access for Ukrainian agriculture exports (Chapter 16) and emphasizes that WTO membership could spare Ukraine from unilateral actions taken by the EU to protect its domestic market from imports of grains.

WTO preparations by an acceding country as regards agricultural policy seem to be especially difficult, as past trade agreements spared out agriculture from the whole set of WTO disciplines. The negotiations on the Agreement on Agriculture are ongoing and present a moving target for WTO membership seeking countries with significant shares in agriculture like Ukraine.

In Chapter 17 *James Gaisford and William Kerr* discuss the positions of different countries in the negotiation process on the Doha-Round Agreement on Agriculture. They conclude, as the negotiation process results remain opaque so far, Ukraine's best WTO accession strategy regarding agricultural policy should concentrate on developing a sound domestic policy, broadly consistent with the existing Uruguay Round Agreement on Agriculture.

This means pursuing market-oriented reforms in agriculture and increasing the transparency of domestic trade policy regimes. Important in this respect are

transparent prices for inputs, grain, and other agricultural produce. Increased competition would reduce the very high marketing costs for Ukrainian agricultural produce.

Market oriented reforms in Ukrainian agriculture are becoming even more important, as currently the EU is increasing its protectionist measures, aimed explicitly at Ukrainian and Russian grain exports. Moreover, the accession of the Central and Eastern European Countries to the European Union by May 2004 will have a significant impact on Ukrainian grains exports to this region as well. Ukraine's only opportunity to react to this protectionist measure of the EU will be within the multilateral framework of WTO and the ongoing negotiations on the new Agreement on Agriculture. This makes decisive steps towards accession even more important.

While the prospects of overcoming protectionist developments on the world grain markets are of a rather short to middle-term nature, the long-term perspective is even more promising for Ukraine. *Martin von Lampe* in Chapter 18 provides the OECD outlook on middle to long-term developments on the world grain markets. A significant increase in demand in the Non-OECD area is forecasted. Ukraine could tremendously benefit from the future developments by consequently pursuing market oriented agricultural reforms now and hence increasing its international competitiveness. Ukraine could become a significant supplier of the world grain markets, given the country's high agricultural potential— an opportunity Ukraine should not let pass by due to lacking structural reforms in agriculture and grain marketing.

*Stephan von Cramon-Taubadel and Sergiy Zorya* argue that, within reach of an agreement on Ukrainian membership in the WTO, the agricultural conditions attached to the membership do not seem to be particularly onerous (Chapter 19). Agricultural policy in Ukraine is still being much in flux after the turbulent changes during the 1990s, meaning that no vested interests could petrify as regards agricultural policy. Hence the liberalization and market opening attached to WTO membership should be of minor political concern. If only for this reason, Ukraine should welcome WTO membership and make every effort to secure it quickly.



## **PART I**

# **Accession to the WTO: Ukraine's Political Commitment**

# **1 Ukraine's Commitment to Become Member of the WTO**

**Mykola Azarov**

**First Vice-Prime Minister and Minister of Finance of Ukraine**

Ukraine's top policy-makers attach a considerable importance to the issues of accession to the World Trade Organization and Ukraine's integration into the world economic institutions.

Accession of Ukraine to the WTO is one of the top priorities of foreign economic policy of Ukraine. In the Presidential address to the Parliament of Ukraine, which is entitled "The European Choice", the accession of Ukraine to the WTO is described as an absolute prerequisite for launching a number of initiatives aimed at creating a free trade zone between EU and Ukraine.

I do not think, therefore, that I am going to surprise you by expressing my assurance that this is a priority in the work of the new government.

I am pleased to note that nobody is talking any longer about whether it is expedient for Ukraine to accede to the WTO. The answer is clear to everyone. The WTO is a leading international organisation in the area of external trade that unites under its auspices 145 countries, the share of which accounts for 96% of international trade.

The problem lies in a different perspective. Under what conditions can Ukraine accede to the WTO and when?

The requirements for Ukraine's accession are tough and the negotiation process is extremely complicated in spite of the fact that Ukraine has already come quite close to the point, when a decision is due to be made soon on preparation of the final documents. They are the Report of the Working Group on the status of Ukraine's application for accession to the WTO and the Protocol of Accession.

Ukraine has already made considerable progress on its way to the WTO membership. Nine bilateral protocols on access to the markets of goods and services have been signed with Mexico, Uruguay, New Zealand, Canada, South Korea, Slovenia, Latvia, Georgia and India. Bilateral negotiations have been

completed with the EU and Hungary. Negotiations with other member countries of the Working group are in the process of completion. More than 95% of tariff items, which are contained in Ukraine's consolidated tariff proposal, have already been agreed upon. The time frame for specific commitments in the services sector has been practically finalized.

Regrettably, as regards the bilateral negotiation process we have been confronted with a situation, when a number of countries demand some concessions from Ukraine, which are economically groundless not only from Ukraine's perspective, but also from the perspective of some other countries. In fact, there are some countries, which support Ukraine's accession to the WTO in their political declarations but put forward during negotiations such demands that significantly slow down the process of Ukraine gaining membership in the WTO.

The above-mentioned facts, however, are showing the objective difficulties inherent in the process of negotiations. On its part, the Government of Ukraine will do everything in its power to complete negotiations on acquiring the WTO membership as soon as possible.

To this end, it is necessary to address a number of priority issues.

The determination of Ukraine's commitments in the area of agriculture is still under way. The issue of volumes for import of raw cane sugar and mechanisms for implementation and distribution of tariff quotas on such imports is one of the sticking points to be resolved with a number of member-states of the Working Group on Ukraine's accession to the WTO. This point is still in the process of agreement.

Measures are taken with a view to immediately address a range of problematic issues in bilateral negotiations with member-states of the Working Group. We hope that this will allow us to gain support of many influential WTO member-countries at the next session of the Working Group and a decision to start preparation of the Protocol on Ukraine's accession to the WTO will be finally taken.

The list of problems is quite long, but I remain quite optimistic about it and there are ample grounds for that. Over many years the main problem of negotiations on Ukraine's accession to the WTO has been in the area of bringing the national legislation of Ukraine in compliance with the norms and requirements of the WTO agreements. For several years our counterparts at negotiations on Ukraine's accession to the WTO have been emphasizing one of the main sticking points, namely the incompatibility of Ukraine's regime of intellectual property protection with international norms.

But progress has been achieved over the previous and this year alone. A number of laws and executive orders have been adopted in this area. The Government has elaborated and submitted for consideration to the Verkhovna Rada a draft law of Ukraine "On making changes to some legislative acts of Ukraine related to issues

of intellectual property". It is intended to amend a number of laws in the area of intellectual property to bring the national legislation into full compliance with the norms of the TRIPS agreement. On the 28th of November 2002 the Verkhovna Rada examined this draft in its first reading. At the same time, the Government of Ukraine is aware of the fact that the challenge lies in enforcement of the enacted laws and taking effective measures aimed at preventing production and sale of pirate audio and video products and computer software on the territory of Ukraine. A special unit has been established within the legal protection of intellectual property system to deal with legal issues of computer software. The national register of producers and distributors of computer software as well as the information inquiries system that would deal with distribution and use of licensed computer software are in the process of getting established in Ukraine. A sub-unit of state inspectors in charge of intellectual property legal issues has been established within the government in order to exercise state control over economic agents' compliance with legislation in the area of intellectual property. The relevant sub-units within the Ministry of Interior, State Tax Administration and State Customs Service are engaged, on an ongoing basis, in preventing possible actions that might violate the intellectual property rights.

Similar policies are pursued in the other areas of national legislation with a view to bring them into compliance with norms and requirements of the WTO. The Customs Code elaborated in compliance with all the requirements of the WTO agreements has been adopted and implemented in Ukraine. Activities on harmonisation of our standardisation and certification system and public procurements are now focused on technical details given that systemic issues have already been addressed.

Now that a coalition government has been formed and a shared responsibility of the Government and the Parliament has been established, the situation can be expected to improve in the area of legislative support of Ukraine's accession to the WTO. The effective majority in the Parliament is now able to deliver the adoption of priority legislative drafts within the shortest period of time. As regards Ukraine's accession to the WTO and reform of the trade regime in compliance with international standards and liberalisation of economic policy the Government enjoys the support of the rest of the deputies of the Verkhovna Rada, too.

An effective structure has been formed with a view to ensure cooperation of the Government with the Parliament. The joint Working Group consisting of people's deputies, government officials, businessmen and academics has been established to address the issues of Ukraine's accession to the WTO and implementation of the national legislation. The group is co-chaired by Mr. Zinchenko, the deputy speaker of the Verkhovna Rada of Ukraine, and by Mr. Honcharuk, the state secretary on trade. The establishment of this Working Group has allowed us to deal efficiently with the problems of legislative backing of Ukraine's accession to the WTO.

An ongoing cooperation has been established with selected committees of the Verkhovna Rada. A joint meeting of Ukraine's government officials involved in the negotiation process on WTO accession with three select committees of the Verkhovna Rada was held on October 16, 2002. These were the Committee on agricultural policy and land issues, the Committee on economic policy, national economy, ownership and investments, and the Committee on industrial policy and entrepreneurship. There is a growing awareness of the difficulties that Ukraine may face during the initial stage following its accession to the WTO. On the other hand, there is also a strong understanding that accession to the WTO is a necessity for Ukraine since it will help the country to integrate faster into the world economic community and develop into an economically advanced country within the shortest period of time.

The inter-agency commission on Ukraine's accession to the WTO has launched a publication of the news bulletin "International trade news" and has nearly completed the establishment of a web page "Ukraine and WTO".

I would like to re-iterate again that the deadline for Ukraine's accession to the WTO has been determined in the Presidential address "European choice" as the year of 2003. We'll spare no efforts to complete negotiations on Ukraine's accession to the WTO that year. But Ukraine's government will never make any concessions that can make an irreparable damage to Ukrainian manufacturers and producers. We are perfectly aware of the price that we must pay for our accession to the WTO and we're willing to pay such price, but we must strike a positive balance of those advantages and disadvantages that result from Ukraine's accession to the WTO. We should maximize all the advantages of the WTO membership and minimize its possible negative implications.

## **2 Towards Membership in the World Trade Organization**

**Hector A. Millan**

**Senior Counsellor, World Trade Organization**

H. E. the Minister of the Economy of Ukraine and Chairman of the Governmental Commission on Ukraine's Accession to the WTO, and the other distinguished participants.

I would like in the first place to convey the greetings of the Director General of the WTO, Dr. Supachai Panitchpakdi, who is a firm supporter of the enlargement of the membership of the WTO to make it a truly universal trade organisation.

As you know the terms of accession to the WTO are negotiated between the Members and the applicant Government. The Secretariat plays a small role in facilitating the process of accession and trying to bring it to a satisfactory conclusion in the shortest possible time.

Ukraine is one of the largest economies still outside the WTO. The economy, the politics and the integration of Ukraine in the world economy, that is the whole future of the country are all linked together. I shall address the progress that has been made by Ukraine in the accession negotiations to the WTO and the challenges that lie ahead of us.

### **Ukraine and the WTO**

With the Marrakesh Agreement Establishing the WTO which entered into force in 1995 replacing the GATT, the General Agreement on Tariffs and Trade of 1947, the Multilateral Trading System has become tri-dimensional.

The WTO deals with trade in goods, trade in services and the Trade-related intellectual property rights setting up a common institutional framework on the basis of the concept of the single undertaking.

Practically all the signatories to the Marrakesh Agreement and some 16 other Governments, who have negotiated accession pursuant to Article XII of the WTO Agreement, have become Members of the WTO. Thus, after a few years, the Membership of the WTO has increased from 128 to 144 Members. Currently, some thirty small, medium size and big economies are seeking accession to the WTO. In addition to Ukraine, they range from the Russian Federation and Saudi Arabia, to Azerbaijan, Belarus, Kazakhstan, Uzbekistan and Serbia and Montenegro, - the former Federal Republic of Yugoslavia -, to Vanuatu, Seychelles, Tonga, Cambodia, Ethiopia, Yemen and Nepal.

At the outset, I would like to emphasize that in pursuance of Article XII of the WTO Agreement, accession to the WTO is a negotiation and not the setting up of a unilateral instrument of incorporation or a voting process as may be done for membership in other international organisations.

The early application for accession to the WTO submitted by Ukraine and the establishment of an interagency body, the Governmental Commission on Accession to the WTO confirm the general understanding that Ukraine is too important a country to remain outside the mainstream of international trade and economic relations.

The world economy needs predictable international rules and strong institutions to enforce them. This is the role of the WTO.

It is a fact of life that participation in the increasing number of bilateral or even regional trade arrangements, is not sufficient for a country to share in economic growth and development and to secure a larger share of foreign investment, modern technology and modern production and distribution structures.

The process of economic reform and transformation of Ukraine to a market economy needs to be consolidated through participation in the multilateral trading system, on an equal footing with other WTO Members, including other important economies in transition.

As accession to the WTO is a national undertaking, it is very important that your negotiators coordinate closely with all the branches of the public and private sectors, in order to consider the interests of all the productive sectors, including industry and agriculture and services providers, as well as those of the consumers of Ukraine.

An accession negotiation to the WTO is not about free trade but about trade liberalisation. A counterpart by the acceding government to the existing trade liberalisation commitments accomplished in the WTO framework has to be established.

Import duties on goods, including agriculture, will have to be bound in the WTO at levels acceptable to WTO Members, with staging if necessary, and any other suitable modalities for sensitive products, commodities and sectors. Non tariff

measures including internal taxes, import licensing, subsidies, technical barriers to trade, sanitary and phytosanitary measures will have to be applied consistently with the WTO principles and rules. Horizontal and specific commitments will have to be undertaken in the services sector.

The protection of intellectual property rights will have to be observed consistently with the relevant international conventions and the WTO Agreement on TRIPS.

Each WTO member and prospective member therefore benefits from, and will benefit from, the actions it undertakes in conforming to WTO disciplines.

Domestic reforms aimed at attaining economic development and trade diversification, increasing employment opportunities, full participation in the globalized age of information have been and will remain among the most powerful justifications for trade liberalisation.

The WTO system is essentially a network of contractual rules and commitments capable of being monitored and enforced multilaterally. Its central feature is predictability and certainty in conditions and terms of trade. It guarantees the business community and consumers that governments will maintain open and accountable trade regimes. To this end, all WTO members are obliged to have in place legislation and enforcement mechanisms that are needed for them to implement their WTO obligations.

The Working Party on the Accession of Ukraine has noted as important contributions to the process of accession, *inter alia*, the survey of legislation related to the foreign trade regime, the analysis of compliance with the requirements of the WTO Agreements, the schedule for the approval of draft laws and normative acts in the trade field by the Supreme Rada, the law enforcement legal framework and the legislation submitted.

In the period 2001-2002, some 16 important legislative texts, including the Customs Code were enacted and are already in place. The Legislative Action Plan lists some 15 legislative texts, including the Tax Code, which are due to be enacted in the latter part of 2002 and in the course of 2003. These encouraging developments need to be accompanied by their effective implementation.

WTO Members look forward to receiving the texts of the draft legislation and regulations as soon as possible as well as a detailed follow up to the legislative action plan. We know that this will be quite demanding on the Governmental Commission and the Supreme Rada but it is an essential part of the completion of the process of accession.

Ukraine can draw on the expertise of the WTO Secretariat and the technical assistance that individual Members can be expected to provide to make this possible. I believe that no one would question the statement that some important progress has been made in the accession negotiations over the recent months.



In the bilateral market access negotiations it is very encouraging to note that the Governmental Commission has concluded bilateral agreements with several Members. For the purpose of the preparation of the checklist of issues, Members expressed support for the rapid accession of Ukraine to the WTO based on meaningful market-access commitments and on the full respect of WTO rules. In respect of the market-access commitments undertaken during the negotiations, Members have noted that the commitments undertaken so far were of a very high standard both compared with other accessions and the commitments of current members of the WTO. In this respect, besides recalling the need to respect the standstill principle that should be observed by acceding countries in the course of the negotiations, these members considered that Ukraine has fulfilled the reasonable expectations of the membership and it should be possible for all Working Party members to conclude the negotiations expeditiously. Even though agreements still need to be reached with certain other major trading partners important progress has been made.

A further effort is needed to close the remaining gaps. In our experience this means that there will be need for further flexibility.

In the agriculture sector, the examination of the system of domestic support and exports subsidies has advanced. Comprehensive data on the Strategy of Ukraine's Agriculture Development is on the table. Members have noted that Ukraine does not accord export subsidies and are considering the consistency of the domestic support regime with the disciplines set out in the provisions of the WTO Agriculture Agreement. The definition of the base period is essential for this purpose.

It has been noted that some of the requests may appear to go beyond the current level of the obligations and commitments of Members. This is not surprising in a negotiation and Ukraine will have to evaluate carefully the implications of such requests for its national development, financial and trade interests.

The Working Party has decided to commence the process of drafting a factual summary of its work. This summary will incorporate in due course the commitments made by Ukraine, notably how Ukraine will incorporate WTO disciplines in its domestic legislation. This work has been greatly assisted by the action plans prepared by Ukraine. Members are seeking further clarification as to exactly how and when the implementation and the enforcement of WTO consistent legislation will be effected. Great interest has been expressed in the draft implementing laws and regulations being prepared by the Ukrainian authorities. This is normal in any accession process, and a way must be found to deal with these issues.

Some of the documents submitted by Ukraine for the purpose of the preparation of the checklist of issues are as follows: List of Licensing Bodies; List of Documents to be Attached to Applications for Licenses on Certain Types of Economic Activity; Decree on Excise Duty; Rates of Excise Duties and Import Tariff Rates

for Some Vehicles, for Ethylene Spirit, Alcoholic Beverages, Tobaccos, and Some Articles (Produce); Tax Explanation Regarding the Procedure of Application of Zero Rate Value Added Tax in Export Operations outside the Customs Territory of Ukraine; Revised Action Plan in the Area of TBT; Goods Requiring Sanitary and Phytosanitary Verification Upon Import or Transit; Action Plan for Resolution of Problem Issues of Sanitary and Phytosanitary Control in Ukraine, in Particular at the State Border; Free Economic Zones; Regulation on Allocation of Tariff Rate Quota on Raw Cane Sugar Importation into Ukraine; Position Materials on the Scope of State Support Necessary for the Realisation of the Strategy of Ukraine's Agriculture Development; The List of Domestic Food Products for Children, the Sale of which by the Milk Kitchens, Special Shops and Places Performing the Functions of Distributing Centers is Not Subject to VAT; List and Volume of Goods Which, When Imported into the Customs Territory of Ukraine for the Production of Space Machinery, are Exempt from Import Duty and VAT till January, 1 2009; List of Goods Which are Exempted from Taxes When Imported into the Customs Territory of Ukraine.

It is not possible to forecast when the accession of Ukraine will be completed. Members have made it clear that progress depends on completing the bilateral market access negotiations and successfully addressing the challenges regarding the completion of legislative and enforcement work to put Ukraine in a position, upon accession, to assume the contractual obligations of the WTO Agreements, as well as to genuinely derive its benefits.

We ought to be confident that the outstanding issues will be addressed and that with cooperation, flexibility and spirit of compromise from all sides, we shall be able to conclude our common task successfully.

Finally, I would like to recall that pursuant of the Ministerial Declaration adopted in 2001 at Doha, Ukraine and the other acceding Governments are participating in the current and very ambitious Development Agenda negotiations. Important decisions in all sectors of the negotiations are being developed in the Special Sessions of the Negotiating Groups.

Ukraine and the other acceding governments have the opportunity to be actively involved in the multilateral process.

Additional decisions concerning issues such as trade and investment, trade and competition, trade and the environment, and transparency in government procurement are expected to be adopted at the forthcoming Ministerial Conference to be held in Cancun in September 2003.

### **3 Ukraine and the WTO: Possible Membership Implications**

**Valeriy Khoroshkovsky**

**Minister of Economy and European Intergation of Ukraine**

We should consider the accession to the WTO as a step within the framework of Ukraine's integration to the European Union. Ukraine's European choice is irrevocable, which was stressed several times by the President of Ukraine as well as in his address to the Ukrainian people. The President has set us the task of signing an agreement on Ukraine's associated membership in the EU as early as in 2003-2004. I want to note that economic requirements of the EU to membership candidate-countries, in fact, coincide with the WTO requirements. Therefore, accession to the WTO is one of those requirements by satisfying which Ukraine can acquire the status of an associated EU member. Moreover, the WTO membership is an obligatory condition for Ukraine to enter the EU free trade area.

By way of criticism of the steps that Ukraine has made on its way to the WTO, I would like to remark that, regrettably, we have been conducting negotiations on Ukraine's accession to the WTO for 9 years now. Over the past few years the Ukrainian negotiating party had even made several declarations to the effect that Ukraine was allegedly approaching the final stage of its negotiation process.

It should be noted that our internal assessments as regards the speed and quality of this process differ considerably from those of western experts. It is unlikely that we'll be able to fulfil the Presidential Decree on additional measures to accelerate Ukraine's accession to the WTO. According to this Decree it is envisaged to complete bilateral negotiations on access to markets of goods and services with delegations of the WTO working group member-countries considering Ukraine's bid to join the WTO by October 2002. Now it is clear that it will be impossible to complete the negotiations this year. Firstly, agreements have only been signed with 19 out of 42 member-countries of the working group. Naturally, we have to identify the failings of the Ukrainian party, though I am aware of the fact that the blame for such failings may partially lie with the other negotiating parties as well.

It is also worth mentioning the unsatisfactory status of public awareness campaign concerning the Ukraine's need to accede to the WTO and explanation of the

benefits of the WTO membership as well as the role of this organization in international life as a whole. Hesitation and, at times, direct opposition to the idea of accession to the WTO on the part of business community and some politicians is largely due to low awareness of people regarding the WTO.

The Ukrainian legislation still does not comply, to a great extent, with the WTO rules, especially in the sphere of agriculture, services, investment regulation, tax regulation, intellectual property rights and technical barriers in trade.

The issue of Ukraine's accession to the WTO relates mostly to the area of economy. However, against the background of informational void some efforts are made to impart political and geopolitical overtones to this issue. Regrettably, this factor has more negative rather than positive implications for Ukraine. Russia has explicitly shown its interest in Ukraine's accession to the WTO and it does not hide its intention to synchronize the process of its own accession to the WTO with that of Ukraine. I am certain that Ukraine should consider its cooperation with Russia in the area of accession to the WTO from the point of view of its own advantages. In my view, Ukraine should not be too much preoccupied with the idea of which country is going to be the first to accede to the WTO: Ukraine or Russia. We should rather agree now upon our positions and support that with some explicit agreements that whichever country will be the first to accede to the WTO, none of us will impose any additional conditions on each other.

At present, the issues of possible implications of accession to the WTO and ways of enhancing competitiveness of our economy within the framework of the WTO membership have not been fully identified yet. However, I am certain that the WTO is an instrument of enhancing economic activity. The existence of an efficient trade regime is a key condition for successful economic development of Ukraine. The accession of Ukraine to the WTO will make a positive impact on the development of the state as a whole since Ukraine will have to apply common transparent rules of the game both in the international market and at the level of national and regional economy. Summing up the positive effects of Ukraine's membership in the WTO it is possible to say the following:

- the access of Ukrainian producers to external markets will improve;
- opportunities for protection of national producers as well as the use of international mechanisms for dispute settlement will be extended;
- participation of Ukraine in international multilateral negotiations concerning further liberalization of international trade will be given a new boost.

Further procrastination of the process of Ukraine's accession to the WTO is inadmissible since the WTO itself is undergoing the process of changes. The delay with implementation of accession requirements to the WTO results in the fact that even the shortest possible distance for Ukraine to cover on its way to membership in the WTO will become insurmountable and we should not ignore this fact. It is high time that we should conduct negotiations on accession to that type of the

WTO, which, in the view of its the most influential members, is going to be like within the next 2 or 3 years. The 5th conference of the WTO ministers will be held 2003. On the eve of this conference the WTO will prepare decisions on the issues in 13 areas beginning with traditionally problematic areas (such as agriculture, trade in services, and investments) and ending with intellectual property and e-commerce.

Each new agreement within the framework of the WTO without Ukraine's participation potentially means the emergence of new requirements from the future members of this organization, which is a warning sign for Ukraine as well. Intensification of the process of negotiations with the WTO can only take place if the people in charge of this process are personally convinced in the necessity and importance of Ukraine's membership in this organization. Recently I have said at the meeting with senior officials at the Ministry of Economy that if anyone starts doubting the issue of accession or non-accession to the WTO there is no place for such people within the Ministry of Economy and European Integration. The only possible topic for discussion is how we can accede to the WTO within the shortest possible time but not the issue of whether we should "accede or not accede". The latter is not a topic for discussion.

The Ministry of Economy and European Integration will exert every effort to make the triangle of government, business community and wide public become actively involved in discussing and shaping up Ukraine's position in the negotiation process of accession to the WTO. I consider it inadmissible that representatives of the private sector are actually not informed about the WTO and that they do not participate, in any format, in the discussions on this issue and their interests are not reckoned with in the process of Ukraine's accession to the WTO. I rely on active involvement of public organizations without which the efficient discussion of issues of Ukraine's membership in the WTO could become very complicated. Currently, only some single research centers and think tanks focus their attention on Ukraine's accession to the WTO.

I consider it to be very topical to hold special parliamentary hearings in the Verkhovna Rada. There were even instructions of the Cabinet of Ministers issued on that account. I think that such hearings should take place with the involvement of the wide-ranging political, business and public circles. Regrettably, these hearings have not yet taken place, but we'll give a boost to this process to the utmost degree and we will hold special parliamentary hearings. Moreover, I consider these hearings to be the factor that will accelerate the unification and adaptation of Ukrainian legislation to the standards of the WTO.

Therefore, we unanimously confirm our adherence to the quickest possible accession of Ukraine to the WTO. The Government badly needs an unbiased and rational assessment of positive and negative implications of accession to the WTO in the short-term as well as medium-term and long-term perspective. This assessment will allow us to create necessary safeguards and resort to stimulating

measures. I rely on active participation of research institutions and think tanks in this process.

## 4 The Benefit of Joining WTO

**Roger Lawrence**

**Resident Trade Expert on WTO Accession**

Accession to the World Trade Organization is a difficult and complex international economic negotiation. For most countries it is the most complex they will ever face. The difficulty and complexity of the process stem from the relationship of accession to reform.

Ukraine's accession is taking place in the context of its ongoing transition from a command and control economy to a modern market economy. That transition has two broad aspects. The first is the limitation of the direct intervention of the state in economic matters, and the execution of economic policy through instruments that are market-based and market friendly. The second is the establishment of a predictable, transparent and supportive legal framework that guides and facilitates the operation of the private sector.

WTO accession plays an important role in helping Ukraine advance on both fronts, so as to complete rapidly the process of transition to a modern market economy.

WTO rules require the abandonment of most non-market control mechanisms over international trade. Reflecting this, Ukraine is presently in the process of reducing its use of non-tariff measures and is bringing remaining measures into compliance with WTO norms.

WTO rules lay out the legal framework for businesses engaged in international trade and in trade-related activities. Accession therefore constitutes a big step forward toward putting in place a predictable, transparent and supportive legal framework for the private sector.

Moreover, WTO accession helps expedite the process of reform. The regular meetings in Geneva set periodic deadlines for reporting progress, and therefore help domestic reformers sustain the pace of reform. Moreover, when there is a serious political commitment to accession, technical trade issues that might not otherwise receive political attention at a high level – for example sanitary

regulations — do get high level attention simply because they are part of the package required for accession. This also expedites reform.

When there is serious political commitment to accession, there can be little doubt that the linkage of reform to accession speeds up the process of reform itself. In fact, I believe that the most important short-run benefit that countries receive from joining WTO is the reform that takes place during the process of accession.

The other side of the coin is that the process of accession can not go forward more rapidly than the process of reform. WTO members expect an acceding country to bring its trade laws and trade-related laws into compliance with WTO rules by the time of accession. So the pace of the accession process is determined by the pace of reform. Reform takes time: therefore, so does accession. If a country wants to accelerate accession, the only way to do so is to accelerate reform.

Where does Ukraine stand in the process of accession and reform?

Nearing the beginning of the final stage, I believe. But there are significant challenges in the period ahead. Without trying to be exhaustive, I would like to mention three challenges that are especially important.

- a) Agriculture: the task here is to grasp the complex inter-relationships between price liberalisation; state support; the need to complete the transition to a market-based agricultural sector; and WTO rules. Out of all this needs to come to a common understanding between Ukraine and WTO member countries as to whether the levels of state support to agriculture allowed by WTO (through the “Green Box” and de minimis) are enough to allow Ukraine to complete successfully the transition to a prosperous market-based agricultural sector, or whether additional, temporary levels of support need to be authorized.
- b) Non-tariff barriers: I am referring here in particular to quotas and licensing, SPS and TBT. Such measures are used extensively in Ukraine, yet WTO members are not yet sure that they understand fully the scope and character of such measures and the regimes and policies that govern them. In the period ahead it will be necessary to describe such measures fully, provide their WTO justification, and, if there is not adequate justification, modify or remove them.
- c) Legislative reform, implementation and enforcement: some significant progress has been made in this area. The previous Verkhovna Rada passed 15 laws of central importance to WTO compliance during the last 12 months of its activity. This is a good record. The challenge to the present Verkhovna Rada is to continue that pace. This will not be easy, since the present Verkhovna Rada has gotten off to a slow start as regards passage of legislation. It is important to note that forward progress on this front is the net result of two kinds of effort. The first is to ensure that the laws required by WTO rules are passed; the second is to ensure that laws



that contravene WTO rules do not get passed. Both types of effort will be especially important in the period ahead. Government has a particular responsibility to ensure that all laws it submits to the Verkhovna Rada are in conformity with WTO rules.

After WTO-compliant laws are passed, they must, of course, be effectively implemented and enforced. Government should adopt quickly implementing regulations and decisions. The judicial system must prepare itself to meet the challenge of enforcement. No one should under-estimate the difficulties that these tasks entail, or the urgency of tackling them.

## **5 The Legislative Process and WTO Accession**

**Borys Tarasyuk**

**Head of the Ukrainian Parliamentary Committee on European Integration**

The WTO accession is not only the foreign policy priority, but it is the imperative of internal reforming and satisfaction of economic needs as well. Furthermore, Ukraine's membership in WTO is the key element of implementing the foreign policy strategy with respect to European integration. Not only the EU membership, but also being an associated member and implementation of the concept of the EU free-trade zone, set up in the Agreement on Partnership and Cooperation between Ukraine and the EU, are impossible without the WTO.

Ukraine's WTO accession is one of the major priorities in the foreign policy of our state and it is considered as a system factor of the national economic development, foreign trade liberalization, and creation of a predictable environment to attract foreign investments.

In general, the process of Ukraine's WTO accession provides for two major components:

- completion of bilateral negotiations on access to markets for commodities and services with members of the Working Group on Ukraine's accession to the WTO;
- harmonization of Ukraine's legislation according to GATT/WTO disciplines.

### **1 Measures on adapting Ukrainian legislation to GATT/WTO disciplines**

There is an opinion that satisfactory results have been already reached in harmonization of Ukraine's legislation with the GATT/WTO. So, the Ukrainian party handed over the Schedule for Implementation of Priority Draft Laws (alias the "Top-Priority Action Plan"), including 20 draft legislative acts on insurance

services, intellectual property, import of agricultural products, taxation etc., to the Working Group during its 8<sup>th</sup> session. 15 of them were approved by the Verkhovna Rada of Ukraine.

The harmonization of the standardization and certification system, and the public procurement is considered as actually completed; a significant progress is reported in such sphere as sanitary and phytosanitary measures, information services, and intellectual property.

A new Schedule for Implementation of Priority Draft Laws (the so-called phase 2), including 15 draft legislative acts that according to its authors need to be approved by the Verkhovna Rada of Ukraine before March 2003, has been worked-out recently.

In order to ensure consistency in this work and to coordinate actions of executive agencies, a Program of Measures to Complete Ukraine's WTO Accession has been elaborated and approved by a Decree of the President of Ukraine on February 5, 2002. Legislative provisions on accession to the WTO, set up in the Program, foresee a speedy enactment of the laws, which are already submitted to the Verkhovna Rada of Ukraine, as well as elaboration of a number of other draft laws, in particular concerning access to the market for financial and professional services, elimination of technical barriers to trade, sanitary and phytosanitary measures etc.

Moreover, at the beginning of the current session of the Verkhovna Rada, the Ministry of Economy and European Integration submitted another list of draft laws that are needed to regulate the problem issues of trade cooperation between Ukraine and the EU and to bring the legislation of Ukraine into compliance with the Agreement on Partnership and Cooperation between Ukraine and the EU, and with disciplines and principles of the GATT/WTO.

## **2 The actual state of Ukraine's WTO accession process**

The above schedules and lists might make an impression of active work on bringing the legislation of Ukraine into compliance with the GATT/WTO rules. However an analysis of the draft laws implementation reveals that they are insufficient to adapt our legislation to GATT/WTO disciplines. Those, which are elaborated and registered at the Verkhovna Rada of Ukraine, are not defined by subjects of legislative initiative as urgent. Thus, according to UEPLAC, the analysis of preparation and processing of 27 draft laws by the Verkhovna Rada of Ukraine that are listed in the Program of Measures to Complete the Ukraine's WTO Accession (Decree of the President of Ukraine as of February 5, 2002)

reveals that 10 of them have not reached the Verkhovna Rada yet, 6 of the registered draft laws are under consideration and 8 have been already approved. It should be noted that 3 draft laws were rejected by the Verkhovna Rada of Ukraine. These are draft laws On Regulation of Agricultural Products Import Concerning Abolition of Seasonal Duties and non-tariff regulation, On Advocacy and On Quarantine of Plants.

Some important draft laws on harmonization of Ukrainian legislation with the General Agreement on Trade in Services have not been submitted to the Verkhovna Rada of Ukraine. These are draft laws On Television and Broadcasting, On Information Agencies, On Amendments to the Law On Banks and Banking Activity, and others.

At the same time, it should be pointed out that the draft laws, already submitted to the Verkhovna Rada of Ukraine, do not completely resolve the problems of adapting Ukraine's legislation to GATT/WTO rules. This was repeatedly highlighted by both Ukrainian experts and representatives of the European Union Commission. For example, the draft law on amendments to the Law of Ukraine On Fostering Production of Automobiles in Ukraine, aimed at bringing the system of state support to automobile construction industry into conformity with the Agreement On Subsidies and Compensation Measures and the Agreement On Trade-Related Investment Measures, essentially preserves the current privileges in this sphere. In addition, there are other two draft laws, which partially bring the Ukrainian legislation on this issue into compliance with the GATT/WTO (On Amending Article 3 of the Law of Ukraine On Patenting Certain Types of Entrepreneurial Activity concerning copy-books). According to representatives of the EU, it would be advisable to adopt appropriate decisions in form of a single legislative packet embracing issues of tariffs, VAT, excise taxes etc. Unfortunately, this sensible suggestion has not met approval on the Ukrainian part. And there is a plenty of such examples.

Not everything goes well in the field of WTO negotiations on tariffs too. Ukraine has raised tariff rates step by step despite the standstill requirement for the WTO accession. The latest example is the increase of the export duty on the ferrous metal scrap approved by a corresponding Law of the Verkhovna Rada of Ukraine on November 28, 2002. If we nevertheless regard joining the WTO as our objective, we should respect expectations of the WTO regards standstill of both export and import tariffs, discuss their changes with trade partners and notify economic and business circles appropriately and beforehand, in proper enough time.

## 6 The Importance of WTO Consistent Policies

**Yuriy Yekhanurov**

**Head of the Ukrainian Parliamentary Committee on Industrial Policy and Entrepreneurship**

For the last 10 years the process of globalisation of the world economy has been speeding up, that's why Ukraine is predestined to enter the World Trade Organization. This is certain to happen: either in the distant or the near future, but for all that essentially the process of preparation is quite indicative. On the one hand, the public opinion on the expediency of such a step is still controversial, and on the other hand, the government makes an excessive use of declarations that are not corroborated by real actions. And there is an explanation for this.

Firstly, the Ukrainian society is not ready to work out its own maximally independent standpoint at public problems because it lacks appropriate experience. Declarative statements of high-ranking officials that were issued in the absence of structural changes in the economy, under weak support for small and middle-sized businesses as well as preferential treatment of certain industries and enterprises virtually killed the interest to the process of WTO accession on the part of economically active population. Besides, the sessions of the WTO Working Group with participation of Ukrainian representatives are too confidential. The public utterance of national officials represents the negotiation process only in general phrases or one-sidedly providing no copious information sufficient to thoroughly assess Ukraine's position and the consequences of its WTO accession. In this respect, we can talk about a lost opportunity to bring urgent matters of the state and society to public discussion.

Secondly, excessive use of declarations on the part of public agents can hardly be regarded as accidental. The World Trade Organization is an international institution establishing and enforcing new business rules in the world. The case of European Union has shown that economic globalisation virtually wipes out the inter-state borders hampering development of entrepreneurship, i.e. capital and investment flows. That is followed by growth in welfare and quality of life of regular citizens. The rate of this growth depends immediately on the pace of

economic processes. In this case the administrative staff machinery loses its command and control function on the domestic level turning into one of the managers in the public sector. It is the fear of remaining with no control instruments that is the main reason of impeding Ukraine to join the world economic community.

In the meantime, the essence of the issue of joining the WTO is not to determine positive or negative “moments” of the accession but to develop the effective tactics for negotiating that should be targeted at buffering the negative impacts and strengthening the positive ones. At this point, the very economic policy of the government should proceed from ensuring harmonisation of national economic interests with the transformations, which Ukraine would be forced to when gaining membership. That’s why the experience with WTO accession of countries with a comparable level of economic development is of extreme importance and value. Ukraine’s accession to the World Trade Organization should be considered as a necessary initial condition for efficient continuation of European integration.

Problems that should be addressed in the first place are the following:

- inconsistent procedures of import licensing and application of antidumping and special measures;
- arbitrary excise taxation of domestic and import products;
- non-compliance of standardisation and certification regimes with WTO agreements;
- lack of a unified duty for vehicles crossing the border of Ukraine and non-parity of duties for foreign and domestic vehicles.

We should clearly outline for ourselves every step towards the World Trade Organization, paying attention both to benefits and disadvantages of this process. Taking into account that the key requirements of the WTO are “the increase of imports” and trade liberalisation, Ukraine should create for a significant part of Ukrainian producers the conditions, under which their products will not be competitive with their import counterparts. Making WTO commitments, Ukraine should considerably restrict the use of subsidies in the national economy. The Uruguay Round Agreement on Subsidies and Countervailing Measures introduced a lump of various restrictions to all types of subsidies, no matter are they provided to exporters or not.

It should also be noted that Ukraine should urgently address the main issues of adapting the national economic legislation to WTO provisions, at least concerning some preferential measures. The state support to the economy (subsidies) should be precisely defined in Ukrainian legislation. At present there are no general disciplines regulating its application as the instrument of the state policy. That’s why Ukraine should establish a system of control over the state support and define the authority of the state agencies, which will decide on its provision.

We have to admit that the negative impacts of accession, which are so scaring (not without a reason, by the way) to representatives of whole industries of Ukrainian economy, are not likely to be caused by external factors. In fact, they result from ineffective competition encouraging state policy. That's because up to now the state has pointed out with one hand at the goal of its movement – building up the market economy – and with the other hand it has annihilated the basic principle of the market economy – the sound competition ensuring efficient allocation of resources between the industries.

Let's quote the following example: According to estimates of the Ukrainian Academy of Agricultural Sciences, the Ministry of Agricultural Policy, the State Department for Food, and the National Association "Ukrtsukor", making Ukrainian market accessible to raw cane sugar, as required by the WTO, will have absolutely negative economic and social implication for the domestic beet-sugar industry. They will affect not just individual firms but all 192 Ukrainian sugar enterprises (this complex has employed 1.5 million people in 19 oblasts of Ukraine in recent years).

The basic instrument of this "divarication" is the industrial policy of the government that means – in the Ukrainian version – provision of unjustified preferences not merely to certain industries, but also to particular enterprises of these industries. The government of Yushchenko took successful measures in removing these preferences, but the activity of the successive government partially run a pen through these achievements. The current Government is also in jeopardy of repeating these mistakes.

Thus, one should admit that the problem with accession to the World Trade Organization in 2003 (once the year 1998 was declared one of the first deadlines for accession) results from the unbalanced and above all unpredictable economic policy in our state. The precedent government working without an approved action program is another argument in support of this conclusion. The activity of the current government concurs with preparation of such a program, however that does not preclude pompous statements on the WTO accession in the short run.

Thus, a clear-cut long-term development plan for the national economy will finally put a end to debates on positive or negative implication of accession to the World Trade Organization. At the same time, its elaboration will allow to switch the public debate into a constructive channel – looking for most efficient ways to harmonize the national legislation and economy with corresponding world-level standards. On the other hand, the WTO accession should create initial conditions for introduction and maintenance of a competitive environment and fighting corruption. Increased transparency of the public economic policy, and abolition of preferences as such should contribute to improving relations of state officials with businessmen. First of all, these changes should remove the grounds of "uncivilized" lobbying of business interests in public authorities of all levels.

With such prospects in view, we should not waste time, but aimless wandering and neglecting the economic interests is also unaffordable. When considering things realistically, we have to admit that while having no ability to actively influence the geopolitical processes, Ukraine has every prospect to pursue its own geoeconomic strategy. Geographic location, transit crossroads, and approaching borders of the EU give us a unique chance to join the world economic community on most favorable terms.



# **7 Ukraine and the WTO – the Current State of Bilateral Negotiations and Potential Membership Implications**

**Andriy Honcharuk**

**State Secretary at the Ministry of Economy and European Intergration of Ukraine**

## **1 The current state of bilateral negotiations**

The key element of Ukraine's accession to the WTO is the negotiation process within the Working Party on accession to the World Trade Organization. Conditions of a country accession are stipulated during negotiations and at the same time negotiating these conditions entail commitments concerning access for foreign producers of goods and services to the domestic market as well as alterations in the national legislation to make it compliant with the WTO rules and disciplines.

In order to get an insight into the current stage of the negotiation process, the main results reached after the 8<sup>th</sup> session of the Working Party in July 2002 should be named.

Firstly, nine bilateral protocols on access to markets for goods and services have been signed with: India (October 3, 2002), Georgia (June 24, 2002), Latvia (June 20, 2002), Slovenia (March 27, 2002), South Korea (February 20, 2002), Canada (February 20, 2002), Mexico (April 19, 2001), Uruguay (April 20, 2001), New Zealand (June 12, 2001).

Secondly, two meetings of the Working Party on Ukraine's accession to the WTO were held, the Monitoring Meeting and the Official Meeting, both in February 2002.

According to decisions of the official meeting:

- till July 25, 2002 the member-countries of the Working Party have prepared and submitted a request on the foreign trade regime of Ukraine to the Secretariat of the WTO;
- requests of the WTO member-countries were summarized by the Secretariat of the WTO before August 15. A “checklist of questions” concerning the foreign trade regime of Ukraine was formulated on their basis and handed over to the Ukrainian side;
- on September 16, 2002 the Ukrainian side handed over the answers to the “checklist of questions” to the WTO Secretariat;
- on September 30, 2002 the final variant of answers to questions stated in the checklist, after processing additional requests received in September 17, was filed to the WTO Secretariat;
- on October 24, 2002 the document was officially distributed by the WTO Secretariat among member-countries of the Working Party.

## **2 Potential implications of WTO membership**

It is obvious that the process of conditions stipulation, on which Ukraine accedes to the WTO, directly stimulates the discussion of potential implications of membership in this very influential international organization. In this respect it should be noted that the WTO membership provides – in our opinion – a number of benefits to Ukraine, among which are the following:

### **1. Increase of foreign investments into Ukrainian economy.**

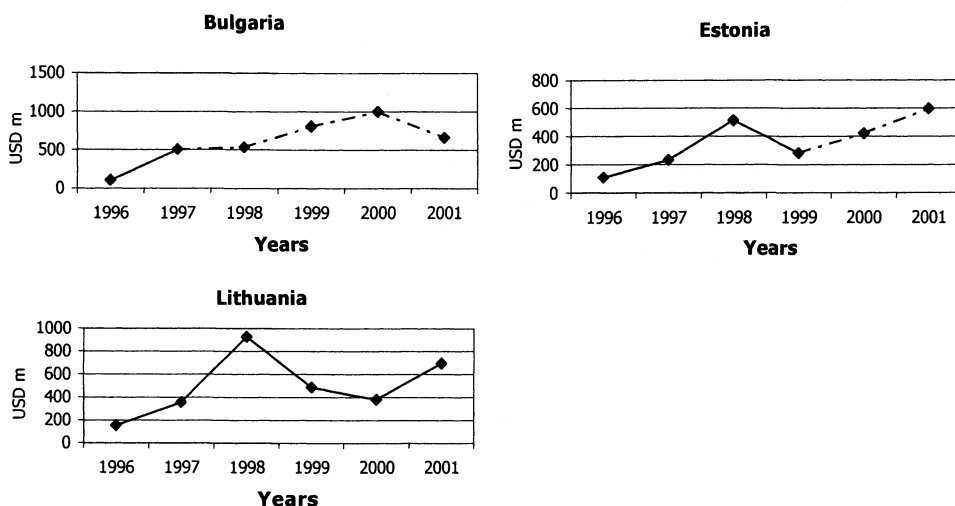
The inflow of foreign capital is certainly determined by many economic and political factors but – in our opinion – the factor of the WTO membership should not be underestimated. In this respect the experience of some member-countries of the WTO should be taken into account(see Figure 7.1).

**2. Liberalization of access to world markets for Ukrainian goods.** The case in point is a possibility to take advantage of future lower customs-tariffs of trade partners as far as they fulfill their commitments according to decisions made at the Uruguay Round of multilateral trade negotiations.

**3. A new possibility to protect interests of Ukrainian producers according to the procedure of trade disputes settlement of the World Trade Organization.**

**Figure 7.1**

Dynamics of foreign investments in some WTO member-countries



4. Evasion of a trade and economic isolation of our state not only from the countries of the Western and Central Europe but also from countries of the Eastern Europe and the Baltic Sea region – many of them will become WTO members after January 1, 2004.

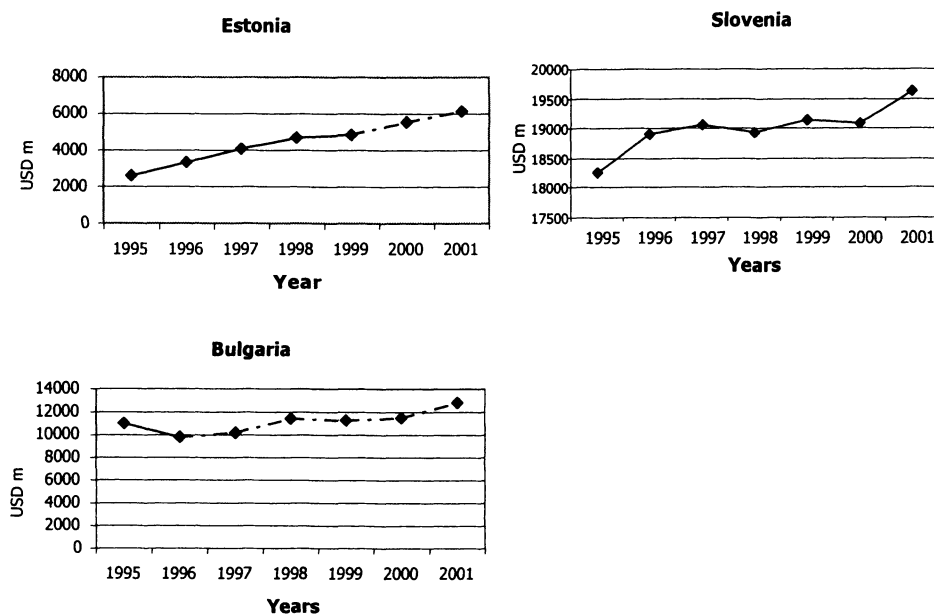
5. Creation of a predictable legislative environment once the Ukrainian legislation is harmonized according to WTO rules. The question in point is bringing Ukrainian regulation environment into compliance with WTO principles and rules.

6. Creation of initial conditions to establish a free trade zone between Ukraine and the EU. It is clear that the WTO membership is an important stage in implementation of Ukraine's European choice.

7. Participation of Ukraine in the new round of multilateral trade negotiations within the World Trade Organization (in case Ukraine gains membership in the WTO before 2005). It should be noted in this respect that participation in that new round of negotiations will allow Ukraine to assert its national economic interests more actively and effectively influence the development of international trade rules.

We can conclude that a more active participation of a country in the world economy can positively influence its GDP dynamics referring to international experience ( Figure 7.2).

**Figure 7.2**  
Dynamics of GDP in some WTO member-countries in transition



### 3 Improved market access

One of principle benefits that Ukraine can derive from the WTO membership will be the liberalization of access to world markets for Ukrainian products. To be more specific, this effect will be achieved in two main forms, namely:

1. Reduced tariff and non-tariff barriers for Ukrainian products to practically all basic commodity markets of developed countries and accordingly increased foreign currency revenues from export of domestic products.

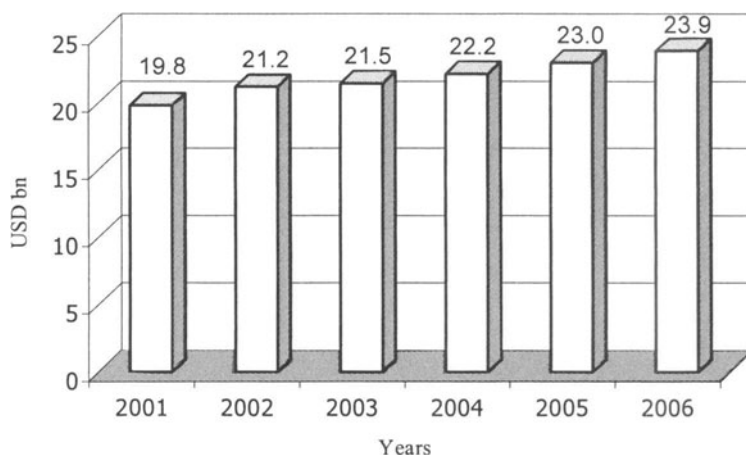
- since 1992 more than 90 antidumping, special, and anti-subsidization inquiries were made against Ukrainian products;
- according to their results markets in value up to USD 2 bn are or can be closed for Ukrainian products;
- Ukrainian commodity exports in value of about USD 750 m are under the threat of investigations or antidumping restrictive measures.

2. A most-favored-nation treatment in the trade area of all the WTO members, i.e. simultaneous improvement of conditions of trade with 144 countries of the world accounting for 96% of world trade.

According to some estimates, Ukrainian exports of goods and services can rise up to USD 23.9 bn (see Figure 7.3) in 2006.

**Figure 7.3**

Ukrainian export of goods and services for 2002-2006 (projection)



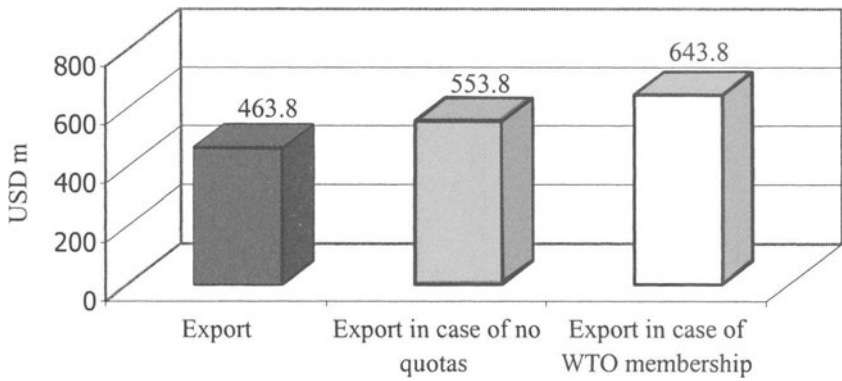
Source: Ministry of Economy and European Intergration of Ukraine

Ferrous metals account for a significant share in Ukrainian exports. This commodity group is subject of numerous antidumping and special inquiries. That's why in case all kinds of barriers to Ukrainian ferrous metal exports are removed, its growth may be expected (see Figure 7.4). The estimates are based on assumption that Ukraine's WTO accession will allow to enforce Ukrainian exporters' positions regards their interest protection.

Now, when negotiations on market access for foreign producers of goods and services are on the way, quite reasonable is the question as of how Ukraine's import volumes can change in response to lower import tariff rates.

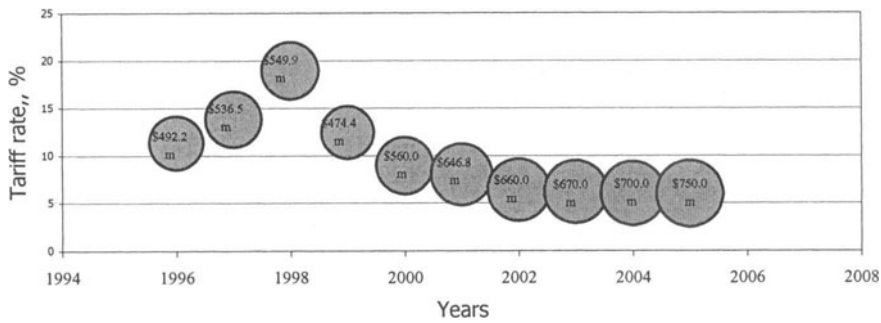
The Ministry of Economy and European Integration evaluates that lower import tariffs (Ukraine's suggestion 2002-2005) will result in increase of textile goods import from USD 560 m in 2000 to USD 750 m in 2005 (see Figure 7.5). This process will of course be followed by a higher competition in the corresponding segment of the domestic market.

**Figure 7.4**  
Ferrous metal exports to EU (projection based on 2001 indicators)



Source: Ministry of Economy and European Intergration of Ukraine

**Figure 7.5**  
Textile goods: import tariff rates. Actual (1996-2001), suggested (tariff suggestion 2002-2005), and projected

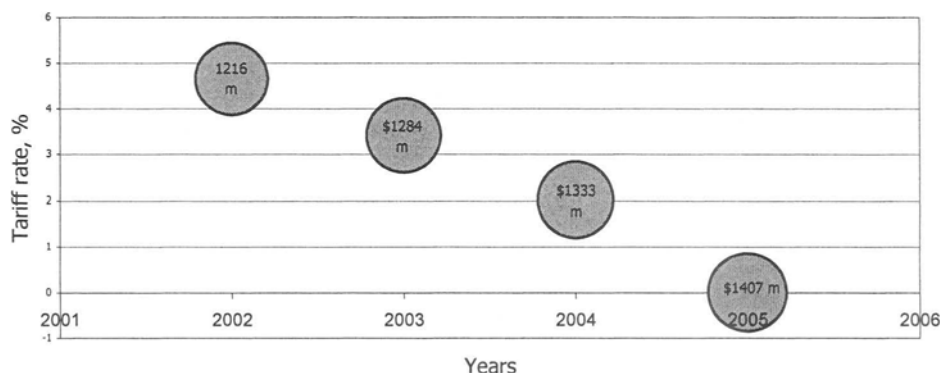


Source: Ministry of Economy and European Intergration of Ukraine

Imports of metallurgy products will also increase according to estimates of the Ministry of Economy and European Integration (see Figure 7.6).

**Figure 7.6**

Metallurgy: products import: import tariff rates according to the tariff suggestion and projected indicators, 2002-2005



Source: Ministry of Economy and European Intergration of Ukraine

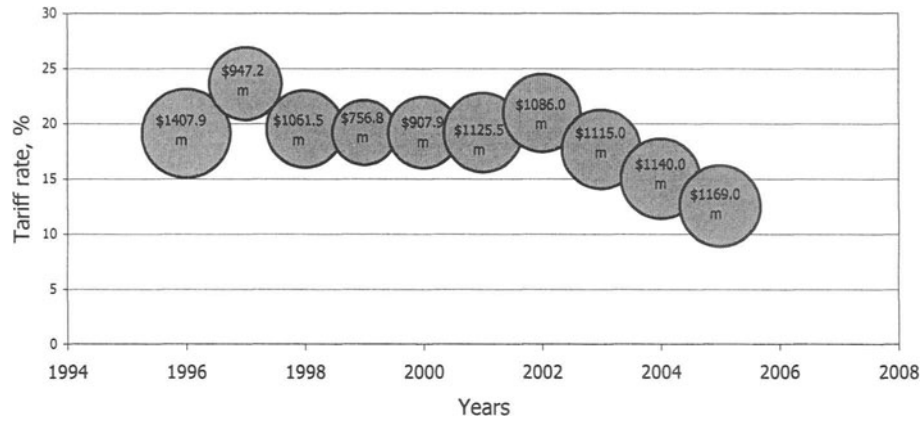
At the same time, the situation in this segment of the domestic market will largely depend on international situation and agreements of producing countries concerning reduction of excessive capacities.

According to estimate of the Ministry of Economy and European Integration lower import tariffs and implementation of the tariff suggestion of Ukraine will be followed by insignificant growth of imports in agricultural produce (see Figure 7.7).

The industry can be expected to substantially raise the import of electric machines and equipment, expressed in relative terms: from USD 717.1 m in 2001 to USD 900 m in 2005.

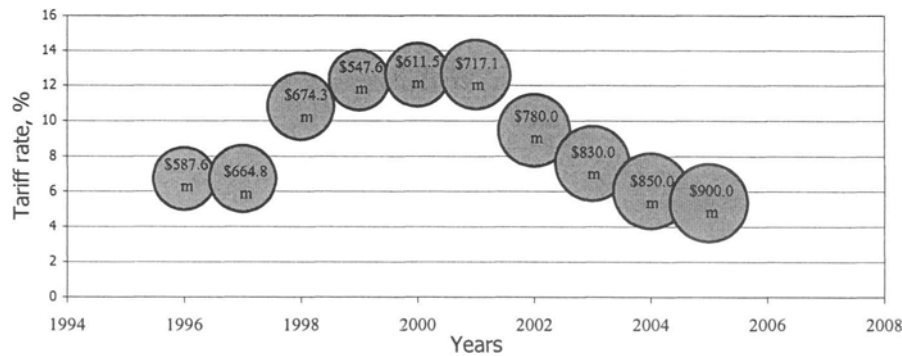
The overall situation in machine building will be determined by the ability of Ukrainian enterprises to improve their competitiveness rather than by Ukraine's accession to the WTO. Of course, the problem of competitiveness should be addressed irrespective of the fact whether Ukraine will be the member of the WTO or not.

**Figure 7.7**  
Agricultural produce: import tariff rates. Actual (1996-2001), suggested (tariff suggestion 2002-2005), and projected



Source: Ministry of Economy and European Intergration of Ukraine

**Figure 7.8**  
Electric machines and equipment: import tariff rates. Actual (1996-2001), suggested (tariff suggestion 2002-2005), and projected



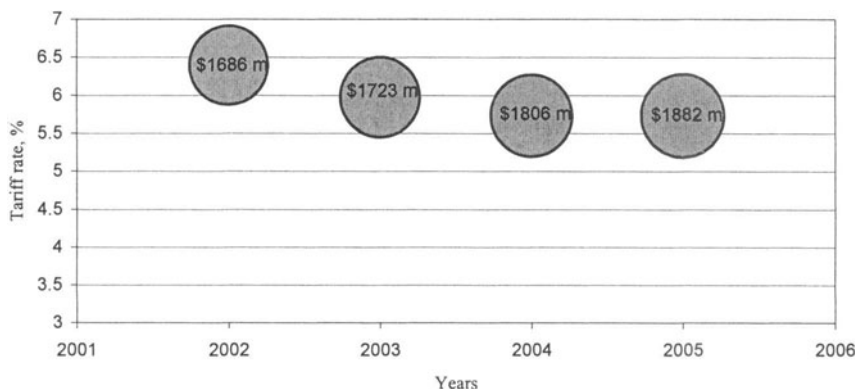
Source: Ministry of Economy and European Intergration of Ukraine

Ukraine has a quite capacitive chemical industry and that's why accession to the WTO will be accompanied by a relatively insignificant increase of respective products import according to estimates of the Ministry of Economy and European Integration.



**Figure 7.9**

Chemical products import: import tariff rates according to the tariff suggestion and projected indicators, 2002-2005



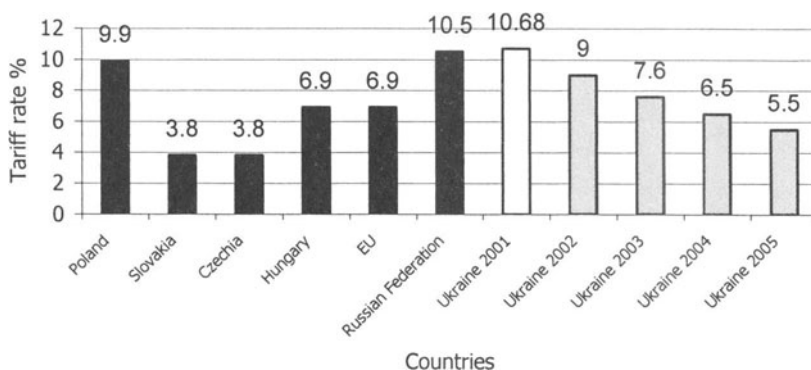
Source: Ministry of Economy and European Intergration of Ukraine

An immediate issue in discussion of the WTO accession is certainly the competition between foreign and domestic producers. In order to get a clear understanding of the problem, a comparison of tariff protection levels in different countries should be made (see Figure 7.10).

The above data show that the average rate of customs-tariffs in 2005 will be approximately equal to the presently observed in the EU. Given the fact that the EU will continue to fulfill its commitments arising from the Uruguay Round of multilateral trade negotiations, the import tariff rates of the EU will be lower than in Ukraine by 2005.

As a general conclusion, it should be noted that development of Ukrainian foreign trade will be determined by many other factors in addition to accession to the World Trade Organization. The world economic situation, the pace of the restructuring and modernization process in the Ukrainian economy, global and regional tendencies in development of certain industries etc should be named among these factors.

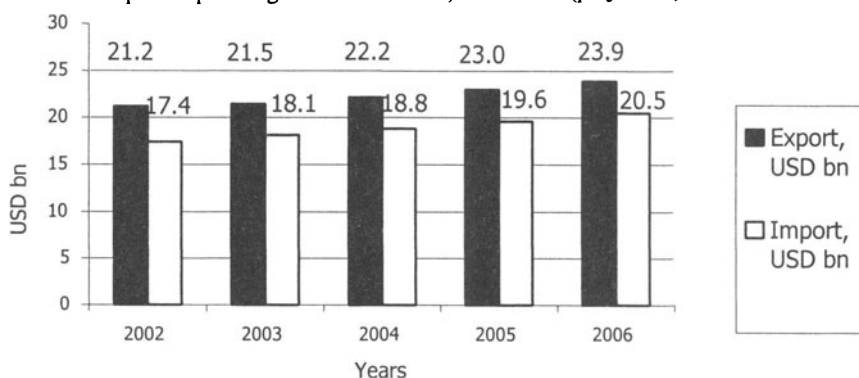
**Figure 7.10**  
Comparison of average import tariff rates



Source: Ministry of Economy and European Intergration of Ukraine

However, reasoning from the current state of affairs, the dynamics of Ukrainian export and import of goods and services – according to the Ministry of Economy and European Integration – will be the following (see Figure 7.11):

**Figure 7.11**  
Ukrainian export/import of goods and services, 2002-2006 (projection)



Source: Ministry of Economy and European Intergration of Ukraine

## **8 Accession of Ukraine to the WTO: New Challenges for Economic Reforms**

**Ihor Burakovsky**

**Co-director, Institute for Economic Research and Policy Consulting**

In modern world, which is characterized by the processes of globalization and integration of countries into the international trading system, none of the countries can afford to remain in isolation and pursue the policy of relying exclusively on its own resources. Therefore, the accession to the WTO is an agenda issue for all the countries. In the long-term perspective it is hard to underestimate a positive impact of all the benefits associated with the WTO membership on the economic development and exports providing that the government implements an appropriate policy and follows the principles of market economy. The lack of such principles is the biggest obstacle for some countries that are engaged in negotiations on the accession to the WTO.

Practically all transition economies consider the WTO membership as an important element in support of their efforts aimed at reforming the economy. Accession to the WTO means that a given country agrees to implement the whole range of measures which will inevitably impact the national economic policy in a direct or indirect way.<sup>6</sup>

In this context, the process of accession to the WTO may be slowed down by the difficulties due to the introduction of legislation and such norms and rules that ensure the compliance of the regulatory regime of a specific transition economy with requirements and rules of the WTO.

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<sup>6</sup> For in-depth analysis of the effects of WTO accession on policy-making in sovereign states see chapter by Bacchetta and Drabek.

## **1 Ukraine on its way to the WTO**

Ukraine announced its intention to become a member of the WTO (GATT at that time) in 1993. In 1994 the Working group was established to address the issue of Ukraine's accession to the WTO. The significant progress achieved in negotiations on the content and principles of economic policy in relevant areas has made it possible for Ukraine to start bilateral negotiations with some countries. The subject matter of these negotiations has been the rates of customs tariffs and Ukraine's commitments regarding access of foreign producers to some national markets as well as some other issues related to trade in goods and services. To date Ukraine has already signed 9 such bilateral agreements.

Though we can speak today about the growing consensus concerning Ukraine's accession to the WTO, the speed of this process can be defined as unsatisfactory. This circumstance has made the President of Ukraine issue two special decrees, which demand that Ukrainian officials act more efficiently in this respect. Therefore, the Cabinet of Ministers has established a special working group, which consists of members of parliament, government officials, and experts, in order to improve the coordination of efforts of different institutions.

At the same time Ukrainian politicians, government officials and representatives of business groups express their concern regarding the capacity of Ukraine's economy to fully take advantage of the WTO membership and endure international competition within the liberalized environment. Such situation is potentially hazardous since the future ratification of the Protocol of Accession will face serious difficulties in Parliament due to the fact that members of parliament are not actually involved into the process of accession and have a weak understanding of the way the WTO functions. And if we add the fact that Ukraine's commitments, which are a prerequisite for gaining the WTO membership, are often considered as something that is imposed on the country from the outside, then it is difficult to ignore the whole range of problems related to Ukraine's accession to the WTO.

## **2 Expected benefits of accession**

Overall benefits from membership in the WTO and such benefits for transition economies have already been widely discussed, so there is no need to enumerate them again. More significant in this respect is how each specific country evaluates possible implications of its accession to the WTO.

At present there are widely common expectations in Ukraine that accession to the WTO will have the following positive economic implications for Ukraine:

- Improvement of access for Ukrainian producers and exporters to major international markets;
- Increase of foreign investments into Ukraine's economy;
- Liberalization of trade regime between Ukraine and the EU, launching of a negotiation process on concluding the agreement on free trade between Ukraine and the EU;
- Reduction of tariff and non-tariff restrictions on export of Ukrainian products of metallurgical, textile and clothing industries to the EU countries;
- Gaining possibilities to protect national producers in anti-dumping and special investigations within the framework of the WTO procedure for adjudication of trade disputes;
- Prevention of trade and economic isolation of Ukraine from countries of Central and Western Europe as well as from countries of Eastern Europe and the Baltic states;
- Establishment of an efficient system of protection of national producers against unfair import.<sup>7</sup>

The above list has enabled us to classify the expected positive economic implications of the WTO membership in the following way:

1. Better access of Ukrainian producers to foreign markets (overall and to some markets in particular);
2. Better opportunities to protect national producers in the process of settlement of international trade disputes;

In line with the above-mentioned the negotiation process as regards the accession to the WTO is traditionally considered in Ukraine as follows:

1. Bringing the regulatory policy in the area of trade and the adjacent areas into compliance with the WTO norms and rules, and
2. Drastic liberalization of access of foreign companies to Ukraine's markets.

But the wider context of implications of Ukraine's accession to the WTO, with a view to elaborate and realize the national economic policy, is practically not discussed in spite of the fact that the WTO activity actually deals with the issues of national policy.

1. Those policy implications (i.e. problems and instruments for their settlement) aimed at the accession to the WTO (raising professional qualifications of the

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<sup>7</sup> Presidential decree No.104/2002 "On program of actions regarding the completion of Ukraine's accession to the WTO" dated February 5, 2002.

personnel involved in the process of negotiations, the need to make the process of accession more transparent, etc.);

2. Implications for the process of elaboration and implementation of the economic policy directly resulting from the WTO membership (changes in national economic policy in line with requirements of the WTO agreements, development of the institutional capacities to meet the country's commitments and taking advantage of the benefits stemming from the WTO membership, etc).

### **3 Advantages for the process of elaboration of the national policy**

It is difficult to evaluate the modality of accession to the WTO and its possible implications for the country as a whole if such modality is still in the process of determination. There is no need to explain that the real effect of the accession depends, inter alia, on the results of negotiations and in this respect the experience of other countries should be examined very cautiously.

But in terms of the national policy the nature of benefits from the WTO membership is quite clear and is well described in economic literature. These benefits can be also considered as goals of accession to the WTO.

*The immediate and the biggest benefit* is actually better access of national exporters to international markets and to the international mechanism of resolving trade disputes. Ukraine considers this benefit as one of the key effects of accession to the WTO. In addition to that, accession to the WTO is a guaranteed possibility to take advantage of the would-be reduction of customs tariffs, which gives the government an opportunity to protect international positions of national producers in the medium- and long-term perspective. This issue is considered to be as one of the most important ones in Ukraine.

It is clear that the nature and scale of the above-mentioned benefits, among other things, depend on the capacity of the country's government to actively participate in multilateral negotiations regarding further liberalization of international trade.

*The second practical benefit from accession to the WTO* is directly related to one of the key principles of international trading system, namely the principle of stability and predictability. Recording of tariff concessions of a given country in the form of legal commitments is a significant signal for national and foreign businessmen as regards the orientation of the government policy in the future.

In case of Ukraine it means the enhancement of Ukraine's attractiveness to foreign investors and improvement of its competitive environment. In practice the WTO

membership can be considered as an international recognition of the fact that the national regulatory environment and the country's policy are based on internationally recognized norms and rules. But in this case the country should comply with the norms and requirements of the WTO not only at the moment of accession but should continue to do so in the future.

*The third positive benefit of the WTO membership* is its positive impact on the national policy and relevant institutions. Bringing the regulatory policy in Ukraine in the sphere of trade and in the adjacent sectors into compliance with the norms and requirements of the WTO means a practical implementation and compliance with the market type code of conduct.

Elaboration and implementation of such legislative and regulatory acts is a process that requires considerable efforts. But, on the other hand, the accession to the WTO provides useful incentives for reviewing laws and regulatory rules towards ensuring their integrity, which, otherwise, might not have been the case if the country did not aspire to the WTO accession.

In practice, norms and rules of the WTO require that applicant-countries should build their regulatory environment on the basis of the following principles:

1. Transparency;
2. Rule of law;
3. Effective enforcement of contractual discipline;
4. Independent judiciary system.

In this respect, accession to the WTO can be considered as an important external boost for implementation of the aforesaid principles as well as the mechanism for introduction of the best (tested) mechanisms in the process of shaping and implementation of the national economic policy.

On the basis of these considerations it is possible to make the following conclusions:

1. Accession and membership in the WTO is an important contribution into improvement of the public administration system;
2. The improvement of public administration leads to the reduction of transactional expenses. Transactional expenses depend on the institutions. Good institutions created by the society (in line with the country's agenda or in the process of practical search) can reduce transactional expenses.

*That is why accession to the WTO and implementation of requirements and norms of this organization should be considered as an element of economic reform on a wide national scale.* On the other hand, the quicker the country can implement market-oriented reforms and liberalize its trade regime, the quicker it will approach the WTO membership.

## 4 Challenges for the process of shaping a national policy

The main idea lies in the fact that benefits of accession and membership itself are not guaranteed to the country automatically. In order to take full advantage of such benefits the country should make a whole range of changes in the process of shaping the national economic policy and create a relevant institutional basis.

Among the various challenges faced by Ukraine in the context of its accession to the WTO the following two challenges should be specifically emphasized:

1. Ukraine should substantially change its economic policy and institutions if it wants to deliver a full compliance of its national regulatory environment to the requirements and rules of the WTO;
2. Ukraine should ensure the functioning of all the institutions, which are necessary for implementation of its commitments.

The aforesaid challenges pose serious issues in the face of the Ukraine's government. The most important among them are the following issues: firstly, specific content of the changes pending implementation and, secondly, investments without which it is impossible to meet the commitments.

Thus, membership in the WTO envisages the restrictive use of such instrument of economic policy as subsidies. The Agreement on subsidies and safeguard measures unequivocally prohibits granting such subsidies, which directly impact trade. It means that Ukraine, as a member of the WTO, must seriously verify each proposal concerning "financial support given by the government or any state body within the territory of a WTO member" (In this manner the Agreement on subsidies and safeguard measures defines the subsidy) to make sure:

Firstly, whether it is possible to define the proposed subsidy as a *targeted* one. According to this criteria a subsidy may be targeted for an enterprise (subsidy is given to a specific enterprise or a group of enterprises), or an industry (subsidy is given to a specific sector), or a region (subsidy is given to certain enterprises located in a specific region).

Secondly, if a subsidy falls under the criteria of a targeted one, it should be referred to one of the following three categories:

1. Prohibited subsidies (export subsidies and subsidies that encourage the use of domestic spare parts and discriminate imports);
2. Subsidies that give grounds for taking measures (within this category the claimant country should prove that the subsidy had a negative impact on its interests); and



3. Subsidies that do not give any grounds for taking measures (non-targeted and targeted subsidies for practical research in industry, promotion of the so-called pre-competitive activity, aid to backward regions, etc.).

This example clearly shows that (1) certain subsidies are prohibited (and such prohibition can be interpreted as some kind of restriction of economic policy related to its failure to use its specific instrument) and that (2) a decision-making procedure requires an elaboration of a procedure for its verification as regards its compliance with the requirements of the WTO; moreover, the implementation of such procedure also entails certain expenses.

Thus, the overall conclusion, which was beyond the scope of attention until the present moment, lies in the fact that the WTO membership imposes not only certain restrictions on application of certain instruments of economic policy but also demands the establishment of such institutions and procedures that would ensure the compliance with rules and norms of the WTO.<sup>8</sup>

*Firstly*, one of the commitments resulting from the WTO membership, which in practice becomes the main burden for member-countries, is the commitment to notify on legislation, policy and procedures in the area of trade. This commitment is directly aimed at ensuring additional transparency of the system of public administration. Each country should send all legislative and regulatory acts to the WTO, which, in fact, means all the information on changes in trade policy and introduction of new norms and rules as well as changes to the existing ones, etc..

This information, in its turn, is automatically disseminated among all the members of the WTO, and it means that they are all constantly informed of the status and changes of trade policy in each country. The same relates to Ukraine. Therefore, the establishment of a relevant institutional capacity is really an absolute necessity.

*Secondly*, membership in the WTO demands certain “discipline” from economic policy at the national level. And in this new capacity the economic regulation needs a new approach. Regulation is not just a totality of laws and norms in certain areas of production and commercial activities; it is an independent process with all relevant implications.

For this process to be effective to a maximum degree it should have a complex and rational structure (the whole process rather than its separate components), which, in its turn, would be based on clear-cut priorities and strategy. Ukraine badly needs such a complex and rational structure in order to harmonize its regulatory policy, which until now has been developing, to a large extent, in isolation by sectors of economy or under the influence of external commitments.

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<sup>8</sup> For in-depth of this issue see chapter by Philip Schuler.

It is clear that membership in the WTO demands certain investments into the establishment of institutional capacities, which must implement commitments resulting from such a membership. At the same time, national producers will incur certain losses due to their adjustment to a new competitive and regulatory environment, which, in its turn, will have implications for the country's economic policy (in terms of re-training of human resources, social aid to the unemployed, informational support to businesses and so on).

The nature of such changes and the amount of relevant investments demand special attention, since the administrative and judicial spheres in Ukraine are still underdeveloped.

Within this context, in our view, the year of 2003 will be a certain landmark in relationships between Ukraine and the WTO because it is the year when the 5th WTO ministerial conference will be held and relevant decisions on a vast range of issues will already have been prepared (see Table 8.1).

**Table 8.1**  
Current and future negotiations within the WTO

Actions	Time schedule
<b>1. Agriculture</b>	
The beginning of negotiations	Beginning of the year of 2002
Setting formulas and specific goals of negotiations	By the 31st of March, 2003
The preparation of relevant draft commitments	By the beginning of the 5th WTO ministerial conference in 2003
The initial summing up of negotiations	The 5th WTO ministerial conference in 2003
The completion of negotiations	By the 1st of January, 2005
<b>2. Services</b>	
The beginning of negotiations within the committee on services	Beginning of the year of 2000
The elaboration of draft requests as regards the access to markets	By the 30th of June, 2002
The initial summing up of negotiations	The 5th WTO ministerial conference in 2003
The completion of negotiations	By the 1st of January, 2005
<b>3. Access to the markets of non-agricultural products</b>	
The beginning of negotiations	January 2000
The initial summing up of negotiations	The 5th WTO ministerial conference in 2003
The completion of negotiations	By the 1st of January, 2005
<b>4. Some aspects of intellectual property rights related to trade</b>	
The preparation of report to the General Council as regards the issues on obligatory licensing and the Committee's report on negotiations concerning the outstanding issues on implementation of agreements	By the end of the year of 2002

**Table 8.1 (cont.)****Current and future negotiations within the WTO**

The completion of negotiations on establishment of the system of registration of geographical names for products	By the beginning of the 5th WTO ministerial conference in 2003
<b>5. Interrelation between the trade and investments</b>	
A decision on conducting negotiations	The 4th WTO ministerial conference in 2001
The beginning of negotiations	After the 5th WTO ministerial conference in 2003
<b>6. Interrelation between the trade and policy in the area of competition</b>	
A decision on conducting negotiations	The 4th WTO ministerial conference in 2001
The beginning of negotiations	After the 5th WTO ministerial conference in 2003
<b>7. Transparency of public procurements</b>	
A decision on conducting negotiations	The 4th WTO ministerial conference in 2001
The beginning of negotiations	After the 5th WTO ministerial conference in 2003
<b>8. Promotion of trade</b>	
A decision on conducting negotiations	The 4th WTO ministerial conference in 2001
The beginning of negotiations	After the 5th WTO ministerial conference in 2003
<b>9. The WTO rules on anti-dumping and subsidies</b>	
The beginning of negotiations	January 2002
The initial summing up of negotiations	The 5th WTO ministerial conference in 2003
The completion of negotiations	By the 1st of January, 2005
<b>10. The WTO rules on regional trade groups</b>	
The beginning of negotiations	January 2002
The initial summing up of negotiations	The 5th WTO ministerial conference in 2003
The completion of negotiations	By the 1-st of January, 2005
<b>11. Understanding in the area of regulating trade disputes</b>	
The beginning of negotiations	January 2002
The completion of negotiations	By March of the year of 2005
<b>12. Trade and the environment</b>	
An arrangement on conducting negotiations has been reached	The 4th WTO ministerial conference in 2001
Reports on relevant issues	The 5th WTO ministerial conference in 2003
The completion of negotiations	By the 1st of January, 2005
<b>13. E-commerce</b>	
The preparation of a report on fulfillment of the working program on studying all the aspects of trade-related E-commerce	The 5th WTO ministerial conference in 2003

As we can see from the above-said, the current trade regime is a very broad range of issues rather than just cross-border rules of trade. Moreover, this range of issues is constantly growing. It is also worth mentioning that currently there is a clear-cut trend for an extension of areas of international regulation, and, therefore, it is highly recommended to participate in this process due to understandable reasons.

In this connection, it is necessary, at least briefly, to remember the topics of current negotiations within the WTO.

Negotiations on agricultural issues were launched at the beginning of the year of 2000 in line with Article 20 of the WTO Agreement on agriculture. By the start of Doha conference the 121 member-countries of the WTO had submitted their proposals. Negotiations will be further continued in line with the mandate authorized by the Declaration of the ministerial conference in Doha. The aim of these negotiations is a material reduction and elimination of barriers on the way to the markets, reduction (with their piecemeal abolition in the future) of all forms of export subsidies and considerable reduction of state support, which distorts the market proportions. Negotiations should be completed on January 1, 2005.

Negotiations on trade in services were started in January 2000 in line with Article XIX of the General agreement on trade in services. They are conducted on the basis of the document and the negotiating procedure adopted by the Council on trade in services on March 28, 2001. These negotiations should be completed on January 1, 2005.

January 2002 saw the start of negotiations on reduction of customs tariffs on all non-agricultural products. The aim of negotiations is to reduce or, where it is possible, abolish tariffs, including reduction and abolition of the so-called peak tariffs, high tariffs and eliminate the practice of tariff escalation as well as non-tariff barriers that restrain goods exported by developing countries. It is envisaged that these negotiations should fully take into account the needs of developing countries and the least developed ones. In this case it is the need to recognize the fact that the aforesaid countries should not undertake the same commitments as the other parties to negotiations or should not grant any concessions in response to commitments of some other countries. At the beginning of negotiations the parties to negotiations should elaborate the formula of such a reduction.

The Doha declaration has set the Council the task of finding a solution of problems, which are encountered by those countries that are using mandatory licensing for medical remedies in case when their own pharmaceutical industry is poorly developed or is altogether missing. In addition to that, a Special declaration on TRIPS and health protection underscored that TRIPS should by no means be interpreted as a ban on taking measures by national governments in the area of public health. The statement points out the possibilities provided by TRIPS in the area of mandatory licensing and the so-called parallel imports. Mandatory licensing means authorization given by the Government to produce a patent-protected product or use a patent-protected process without an agreement of the

owner of the relevant patent. Conditions for giving such an authorization are clearly stated in Article 31 of the TRIPS in order to protect legal interests of the patent owner. Parallel (or gray) import means export of goods produced by the owner of the patent (or copyright, trademark and so on) in one country into another without authorization of the patent owner (Article 6 of the TRIPS).

Currently the work is conducted within the TRIPS Council on creating a multilateral system for registration of vintages and alcoholic beverages containing geographical names. This work should be completed by the beginning of the 5th ministerial conference. The Agreement itself envisages a higher degree of protection of such geographical names. It means that they should be protected even if there is no unfair competition or misleading of consumers. At the same time, some countries have come up with a proposal to increase the level of similar protection with respect to other products while some other countries do not support this approach.

In January 2001 negotiations were started on Anti-dumping Agreements (Article VI of the GATT) and subsidies. The aim of this round of negotiations is to specify and improve the relevant rules and procedures, while keeping the fundamentals, content and principles of the mentioned agreements and take into account the needs of the developing and the least developed countries. Currently the parties to negotiations are busy working out the list of provisions in the agreement, which are subject to specification at the next stage of negotiations. It is also worth mentioning that the ministers have pointed out the need to consider the state of subsidies in the area of fishing, which is one of the important issues for developing countries.

January 2002 saw the beginning of negotiations, the aim of which is to specify and improve rules and norms resulting from the existing provisions on regional trade groups. The situation at present is such that almost all the WTO member-countries are also members of different integrated groups of countries. Therefore, parties to negotiations should take into account the significance of such groups for economic development.

In January 2002, in line with the mandate of the 4th ministerial conference, the negotiations were started on reviewing the Understanding with regard to the settlement of trade disputes, which should end with signing of a relevant agreement by May 2003.

A decision was also taken in Doha to launch negotiations concerning a connection between the WTO existing rules and the commitments of countries as stated in multilateral agreements on environmental protection. At present there are 200 such agreements and only 20 of them have provisions that one way or another are related to trade. The aim of such negotiations is to reduce or abolish customs tariffs on the so-called ecological goods and services (air filters, catalytic converters, consulting services, etc). The Declaration on E-commerce adopted by the Second WTO ministerial conference on May 20, 1998 has demanded that the

General Council of the WTO should elaborate a comprehensive working program to study all the issues related to the development of E-commerce. A decision was made in Doha to continue this work and to commission the General Council to adopt the institutional mechanisms for the full implementation of this program and submit the report on the performed work to the 5th conference.

In spite of its name the WTO is not restricted in its activities by trade issues only. Given the dynamic development of the process of non-regulation of the world economy, the WTO rules and procedures, as one of the key elements of liberalization of economic cooperation, go beyond the boundaries of exclusively trading system. They penetrate deeper and deeper into the traditionally national areas of regulation of economic activities.<sup>9</sup>

That is why, the WTO membership imposes certain limitations on lawmakers. It means that the relevant WTO agreements clearly define which laws can be adopted and which ones may not. They identify the principled fundamentals for specific legislative acts.

It is also worth mentioning that since the executive power (the Government) represents the country's interests in the WTO, the role of the government is objectively enhanced. It is the governments that propose specific issues for consideration. Those issues make up the agenda for the WTO activities. Thus, the role of the government in shaping external policy is growing. And when the Parliament ratifies a relevant agreement, its role in determining its content and scope is dramatically diminished.

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<sup>9</sup> Options for a Parliamentary Dimension of the WTO. Discussion paper presented by Mr. Kobsak Chutikul, MP (Thailand) at the Parliamentary Conference On the WTO, Geneva, 17-18 February 2003 <http://www.ipu.org/splz-e/trade03/2c.pdf>.

## **Part II**

# **Assessing Implications of WTO Membership**

# 9 WTO Accession and Related Trade Strategies: Lessons for Ukraine

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## 1 Introduction

The accession of a country to the WTO has far-reaching implications for the foreign trade of the country in question and for the trade policy-making in that country. How have countries, which have recently acceded to the WTO, coped with the challenges to trade and policy-making? What are the lessons for countries such as Ukraine, which are still in the process of negotiating their entry to this international organisation? These are difficult questions. Drawing lessons from more recent experiences of countries joining the WTO is a difficult task.<sup>10</sup> The level of development, economic history and trade policy of these countries is extremely varied, and comparisons of these countries of only limited use. Hence, the particular considerations that might bear upon the strategy of Ukraine must be discussed in more detail.<sup>11</sup>

In the following, I will raise some broader points concerning trade strategies as they relate to the WTO accession: first, the economics and politics of accession in general; second, the transition to a WTO-compatible trade policy; third, the strategic choices in trade policy in the run-up to accession which should determine the nature of the market access commitments in goods and services; and fourth, recommendations on particular trade issues on which accession will have an impact.

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<sup>10</sup> Some basic factual information can be found in: WTO, The Accession Process, WTO: Geneva, 2002 (WTO/ACC/10, available on the home page <http://www.wto.org>).

<sup>11</sup> On Ukraine's accession issues, see AHT Consulting Group, Strategic Objectives for Ukraine, Kyiv, 2002.



## **2 The economics and politics of accession**

Accession to the WTO is a complex economic process, which requires numerous changes to agricultural and industrial policy and foreign trade policy itself. In economic terms, the liberalisation of imports of goods and services may provide the greatest benefits to the acceding country, to consumers in general and users of industrial inputs in particular, followed by improved access of exporters to foreign markets.

These liberalisation processes may result in a deeper integration of the national economy into the international division of labour, in a specialisation of production according to the principle of comparative advantage and in a better allocation of capital and labour. Trade policy should be seen in this broader context of establishing an open market economy in which price signals drive internal and external transactions.

Second, trade policy may facilitate growth. Trade policy can probably help to raise the long-term growth potential of the economy and thereby promote wealth and higher living standards. Also, trade policy can certainly help to facilitate the transition to more efficient domestic production structures.

A third benefit may result from the change of agricultural and industrial policies of the state which usually becomes necessary before accession to the WTO, if the degree of support to those activities or the instruments used to provide this support are not in line with WTO obligations. In many ways, these changes may help to improve capital allocation and efficiency of the economy itself and should be regarded as an opportunity and not as a threat.

A fourth benefit is usually to be found in the need to increase the transparency and effectiveness of those policies itself, which may over time limit the degree of discretionary state intervention in the economy, at least subject it to greater public and parliamentary scrutiny.

A fifth benefit usually comes in the area of services. Countries may make commitments to open national markets to foreign companies providing services, in particular to businesses. In areas such as finance, telecommunications and transportation, opening up market access may yield high benefits over the medium-term. Foreign direct investment in these activities is of particular great importance; FDI might clearly benefit from national commitments to open markets and the adherence to multilateral rules.

All these benefits do not come as a free lunch in terms of political economy. There are numerous adjustment requirements, which come as threats to income of some producers, as regulatory challenges to national governments and parliaments, and as political challenges regarding the forging of a national trade strategy to governments, parliaments and economic agents alike.

First, threats to income. Trade liberalisation, which is usually associated with WTO accession, may also increase adjustment pressures in the domestic economy, as industries or farmers, which are not competitive in the new environment, will have to adjust. In the extreme, some domestic producers may have to exit certain lines of production, or, in case of single-product companies, be forced to exit the market altogether. Imports may replace domestic goods.

Adjustment pressures in the sense of threats to income may arise at the level of a whole factor of production (example: EU farming), an industry (example: coal or steel in the EU) or a specific firm (example: a textile producer). Depending on the nature of the problem, pressures for trade protection will emerge. A whole factor might be protected, a sector or a company.

The trade rules of the WTO allows for plenty of protection, which essentially is set by national governments (in case of Europe: the EU) and, upon accession, bi- and multilaterally negotiated with trading partners. Protection, however, is subject to constraints on the instruments to be employed and the overall level of protection that can be granted. However, in areas such as agriculture, the WTO still allows for very high levels of protection, which are clearly no longer common in merchandise trade. This proposition holds true for the terms of entry. Often, countries commit themselves upon entry to a further liberalisation of trade within a specified period of time, usually seven years.

Second, an acceding country must usually undertake far-reaching changes in domestic regulatory matters as well. From the protection of intellectual property rights to sanitary and phytosanitary measures, domestic rules must be brought in conformity with WTO rules. Adjusting legislation is a laborious process.

Third, forging a consensus on the terms of accession is usually a difficult political process as well. The government must submit a memorandum on national trade policy and on aspects of agricultural policy and industrial policy to the Working Party and engage in numerous rounds of bilateral and multilateral negotiations. It must also negotiate at home with parliament and important representatives of economic interests about the necessary adjustments in trade policy and legislation. Only if domestic and international negotiations fit together, can the challenge of accession be met.

The international part of the negotiation must lead to consensus in the Working Party, which will require consent of the major trading powers to the WTO-compatibility of national trade systems and policies and to market access commitments, as well as a two-thirds majority in the General Council (or the Ministerial Conference). It also requires numerous bilateral or multilateral agreements on very specific sector- or product-specific issues. It suffices to say that except for the very largest trading nations acceding to the WTO, the asymmetry in bargaining power between the more than 140 member states of the WTO, in particular the USA, the EU and Japan, on the one side of the table and any acceding country on the other side is overwhelming. There is rather little

leeway for those acceding countries, thus. This holds true for the Chinese accession to the WTO as well.<sup>12</sup>

The domestic part of the negotiation requires comprehensive political leadership by the executive, a well organised trade policy team balancing interests among various ministries, strong parliamentary involvement right from the start and at the end, when the Protocol of Accession must be ratified by the parliament, a delicate balancing of domestic interests, and public education and consensus-building on the accession. This applies to the rules of the WTO itself, the necessary policy adjustments, key demands regards market access commitments posed by trading partners and various other considerations such as the pursuit of regional or bilateral trade initiatives and their relationship to WTO law.

The domestic part of the negotiation is particularly important. The WTO framework does not prescribe a specific national strategy in trade policy. There is much room for a high level of protection (and clearly for free trade or anything close to it), for regional integration, for a trade policy favouring import-substitution or export promotion or a neutral stance, and so on. Forging a domestic policy on the long-term direction of national trade policies is a very important but politically difficult issue.

This complexity of the economics underlying the accession to the WTO and of the necessary political process is one of the major reasons why negotiations of accession have taken several years to complete in most recent cases. The process has become extremely complex, time-consuming, demanding on governments and overly oriented towards accomplishing the last detail in legislation in advance of accession. However, the WTO members have shown some flexibility regards the implementation of market access commitments over a period of several years.

### **3 The transition to a WTO-compatible trade policy**

As Ukraine's negotiation is well advanced already, there is no need for a lengthy discussion of the principal tasks of reforming trade and other economic policies here. I would like to stress five major points, however: first, the transition requires, in principle, the termination of many policy instruments such as quantitative restrictions up to outright bans, administrative or technical barriers to trade and trade-related subsidies. As seen from the WTO, the preferred instrument of protection is the tariff in trade in goods. The tariff has to be applied on a most-favoured-nation basis to all WTO members. Preferential tariff rates can be applied to developing countries or member countries of a free trade area respectively a customs union. Some tariff-rate quotas can be used under narrow circumstances.

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<sup>12</sup> See Lardy N. R. (2002).

Regards services, the approach is very different, as markets can be opened up to foreign activity without many changes to border-measures, which usually do not play a big role. In this regard, the schedule of commitments includes areas of desired liberalisation, perhaps with brakes on direct investment or other modes. Market opening should proceed in steps by increasing the breadth and depth of access commitments and by extending MFN-treatment to more countries. In certain service sectors, countries may also simply join an agreement establishing free trade in particular areas, such as information technology.

Second, in agriculture, the requirements are more demanding. There are upper limits for domestic support to be extended to farmers, limits to the use of export subsidies and requirements for the use of tariffs, or tariff-rate quotas, if imports, before accession, are lower than 5% of domestic consumption. Usually, agricultural policy must be comprehensively redesigned to meet the requirements of the WTO. The topic is too large to be covered with much ground here. Suffices to state that agricultural policy reform can play a very substantial role in promoting national economic welfare. The WTO rules out certain forms of highly distorting domestic support, import protection or export subsidies beyond a certain limit.

Third, subsidies to industry and economic activity of public enterprises may give rise to numerous trade issues in the run-up to accession and even later. The issue of state trading might not be of great relevance to Ukraine any longer, as so much privatisation has taken place already. Suffices to say that subsidies to, and price-setting by, public enterprises may easily distort foreign trade and give rise to national contingent protection of both members and non-members of the WTO against the producers of that particular country. In the run-up to accession, the topic has to be treated carefully. The Chinese example is instructive in this regard.

Fourth, basic transparency of the trade regime as well as of domestic laws, which are relevant to WTO provisions, is of utmost importance for accession and after entry. A transparent and well-designed trade policy upon accession to the WTO may well provide an incentive for attracting foreign direct investment in domestic industries, because these investors can build reliable expectations about the trade regime. Investors may not have to fear sudden changes, in particular increases, in protection granted to domestic producers, if tariff bindings are set close to actual applied tariff rates. These lessons apply after accession as well.

Fifth, in case there are already significant national laws establishing instruments of safeguard protection or of contingent protection such as anti-dumping or countervailing subsidy laws, these must be brought into conformity with WTO rules. I would like to address the issue of the desirability of having such policies at all at the end.

## 4 Strategic choices in trade policy

Any country negotiating accession to the WTO will undoubtedly consider the long-term perspective of the national trade strategy in light of the state of the domestic economy and the political situation. For countries in transition to a market economy, particular considerations apply.<sup>13</sup> Those countries have usually gone through a process of fundamental trade adjustment from trade in the domestic context of the Soviet Union and/or in COMECON to a mostly market-based trade situation today. The geographic orientation, the payment infrastructure, the nature of regional trade agreements and the size of foreign trade as a portion of GDP were subject to considerable change. Often, trade is predominantly based on commercial considerations of private companies today, with good prospects of sustainable and high trade growth over the years to come. Current account convertibility is usually in place. VAT and excise tax schemes<sup>14</sup> conform by and large to international standards (country-of-destination principle). Many export taxes, which were previously used, were replaced by much softer instruments early on. Most trade regimes do not exhibit many heavily interventionist instruments any longer. This constitutes considerable progress already.

For most acceding countries, trade in goods is the key concern. For Ukraine, for example, exports of raw materials, metallurgic products, machinery, foods products, textiles and transport equipment matter most. On the import side, energy inputs, raw materials, industrial inputs and investment goods (machinery, transport equipment) and ferrous metals have the largest shares.<sup>15</sup> In some industries, government subsidies, measures of import protection or other interventions still play a noticeable role.

### 4.1 Tariff policy

In most countries, average levels of protection have been brought down to reasonable levels already. If this has not been the case in a particular country, then WTO accession is usually a very good opportunity to liberalise imports, to restructure the tariff system and to bind tariffs in the WTO at reasonable rates. Bindings may be set slightly higher than actual tariff rates as to allow for some

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<sup>13</sup> See Lücke M. (1998).

<sup>14</sup> In Ukraine, the VAT rate on imports from countries, which are not members of the CIS and thus subject to a country of origin taxation, is 20% (since 2001). Excise taxes apply to a very limited number of goods in seven product groups such as alcohol and tobacco. See Bundesstelle für Außenhandelsinformation (BfAI), Zollvorschriften (Exportieren in die Ukraine), 6.11.2001.

<sup>15</sup> BfAI, Datenblatt Ukraine, Wirtschaftsdaten Aktuell, November 2002.

price-based increase in protection over the medium term, if adjustment troubles become too serious.

Further, a simple, transparent tariff structure based on a few rates and limited to no more than 35% as a maximum tariff rate seems to be adequate. Most countries get along with only a small percentage of rates exceeding those levels in industry. In agricultural trade, much higher tariff rates are used, however. Also, a simple structure of tariff rates lends itself easily to ongoing liberalisation later on. The acceding government may even consider a pre-announced strategy of changing the tariff protection granted to certain industries after a specified period of several years. This would allow producers to build rational expectations of further adjustment pressures, respectively cheaper imports, in the future.

It would be desirable to set most tariff rates in a low range of 5 to 20% and use rates in a range of 25 to 35% for goods in need of higher initial levels of import protection. If possible, countries should avoid applying much higher rates in trade in goods. If a price advantage of domestic producers of roughly a third does not allow them to cope with foreign competition, then the problem might be so serious as to reconsider the viability of protection altogether. Maybe such producers should exit the market, allowing users and consumers to reap the benefit of much cheaper imports. Generalisations, however, are of limited use only. The issue has to be discussed in conjunction with the overall policy approach to a particular industry or company, if it is a very large one.

My proposals are not completely out of touch with reality. Developing countries, which are members of the WTO, have managed to reduce average trade-weighted tariffs after the conclusion of the Uruguay Round to 13% and to bind rates on average at 20%.<sup>16</sup> This should be feasible for transition economies as well.

More generally, countries acceding to the WTO must usually accept average trade-weighted tariffs of no more than double the OECD-level, i.e. no more than about 10%. This is a tough requirement imposed on acceding countries by members to the Working Party. There is some scope for tariff peaks, for tariff escalation tuned to protect economic activities with higher value added somewhat stronger and for highly protected products or industries in general, but not very much, as these high levels have to be compensated with much lower levels or free trade somewhere else.

Rather low tariff rates may not be credible or effective, however, if adjustment pressures surmount, if non-tariff barriers are erected instead or if excessive resort is taken to measures of contingent protection, safeguards and so on. It is generally more advisable to begin with credible rates, confine oneself to the use of the tariff as the first-best instrument of protection, bind somewhat higher than at current rates, plan or pre-announce more liberalisation to come over the years and avoid

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<sup>16</sup> See Finger J. M., M. D. Ingco, and U. Reincke (1996).

non-tariff measures of any sort as a matter of principle. If the initial trade regime upon entry proves to be too liberal for economic circumstances and political sustainability, a country may have to face difficult decisions, as adequate instruments of coping with adjustment pressures will be in short supply. Usually, however, governments rather err on the other side.

The WTO-based trade regime does not proscribe a particular national trade strategy. In general, there is plenty of room for quite different rates applied to different industries, implying some tolerance for price-based industrial policies reflecting adjustment pressures or promotion strategies supported by some border protection. Whether the pursuit of a particular sector strategy is a good policy idea is certainly subject to debate. Historical experience with such policies is difficult to read, and policy obviously very complex to steer, such that broad generalisations and simple recommendations do not help.

## **4.2 Agricultural trade**

On farm trade, there is much to be said. The topic will be covered in depth by Cramon-Taubadel and others in this book. I confine myself to the statement that levels of protection in agriculture are usually much higher than in industry but are to be subject to a complex set of rules covering domestic support and border measures as well. Also, the range of tariff rates of 5 to 35% suggested earlier for merchandise trade would be a useful guide for setting rates in agricultural trade, but there the levels of protection granted by major traders such as the EU are still very much higher.

## **4.3 Trade in services**

On market access in services, acceding countries can usually gain the most by allowing for a rather unrestricted domestic market. If there is significant local production, which is not yet fully competitive, a limited commitment may be attempted. However, the supply of high-quality telecommunications, financial or transportation services from foreign sources may become an essential element in national development and pose much smaller problems than import competition in the industrial sector. Often, these service sectors are not developed very much in acceding countries. Market opening then offers all the benefits with little or no adjustment problems for domestic producers. Quite the converse matters: market opening may induce foreign investment and lead to the establishment of a particular service industry on domestic soil in the first place.

Experience evaluated by the WTO Secretariat shows that most acceding countries have negotiated very comprehensive market access commitments regards the coverage of relevant national services markets. Restrictions apply usually to the various modes of supply. As a matter of trade strategy, those (foreign) services

that can play a most useful role for national economic development should receive a rather comprehensive and liberal treatment regards the commitment and the modes of supply. Foreign direct investment may result from a credible liberalisation framework such as the one of the WTO in particular. Usually, the availability of good business-related services fulfils essential infrastructure functions for an FDI in industrial activities.

#### **4.4 Trade-related intellectual property rights**

On intellectual property rights, or TRIPS, I would not like to say too much. The issue is controversial but of limited positive relevance for economic development in most accession countries. The TRIPS agreement is a quite complex agreement that poses severe legislative and enforcement challenges for developing or transition economies. The controversy between the US and the Ukraine over a lack of enforcement of copyrights concerning media products proves the point that there are still problems.<sup>17</sup> There are other well-known items on the agenda. The effective protection of such rights is essentially a must in order to avoid serious conflicts in particular with the United States but also with other major developed trading partners.

### **5 Particular issues**

#### **5.1 Anti-dumping**

Ukraine is already involved in trade disputes involving dumping. Let me be frank on this point. Economic evidence suggests that anti-dumping policies are universally detrimental to national economic welfare, are invariably used to distort trade, are prone to very special interest politics and administered protection, can, under current circumstances of WTO rules, not be designed to address relevant competition issues, on which grounds they could be justified, and – as a matter of policy recommendation – should be altogether avoided. The simple fact that most countries today do have anti-dumping laws does not prove that they are useful instruments. Reforms of anti-dumping rules have usually received the lowest grades in economic evaluations and are one of the biggest problems with the

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<sup>17</sup> USTR Press Release 7.08.2001. The US suspended duty-free status under the GSP for the import of goods from Ukraine due to alleged infringements of copyrights, in particular the unauthorised reproduction of optical disk media (CDs, CD-Roms, DVDs and so on).



lowest likelihood of adequate treatment in the Doha Round. A comprehensive reform would be necessary.<sup>18</sup>

## 5.2 Regional Trade Agreements

The WTO rulebook leaves plenty of room for RTAs.<sup>19</sup> The existing rules are rather soft and allow for a wide range of RTAs to be upheld or created. It might happen that the rules are clarified in the course of the Doha round. The most relevant provisions of Article XXIV suggest that most of the trade of the members should be subject to the RTA and interim arrangements on the way towards a FTA or a CU should last no longer than 10 years. In Eastern Europe and the CIS region, a plethora of bilateral and regional schemes exist today. It seems that a reconsideration of RTA processes in Eastern Europe and the CIS states seems warranted, as almost all countries are on their way to the WTO or joined already. Given the geographically wide trade orientation of the Ukraine, not too much emphasis should be placed on RTAs, except those that substantially liberalise trade with Russia.

Given existing trading structures in the region, a RTA can only fully succeed economically, if Russia were ready to fully engage itself in a CU. Given the complexity of FTAs in terms of establishing the origin of goods, a CU would be clearly more useful than a FTA yet also more difficult to establish. From a trade perspective, a RTA for the region comprising Russia, Ukraine and many other countries in the region could be regarded as a useful target, even though it will be difficult to make it viable economically.

Moreover, over the medium term, strengthening the trade ties to the EU seems to be without a good alternative. MFN-treatment is already in place, which is good news. A free trade agreement may well be a good policy objective for the remainder of the decade, once WTO accession is achieved. Given the importance of agricultural trade and the requirement to include "substantially all" (i.e. about 80% or so) of trade, a rapid success of large agricultural traders in establishing such a FTA might become a difficult endeavour.

Let me state from a pure economic point of view that most FTAs that are discussed or in place these days do not yield great benefits. In countries with highly constrained administrative resources in trade policy-making, joining the WTO and making membership work afterwards should be the key pre-occupation, as the economic benefits will be substantial.

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<sup>18</sup> See Messerlin P. (2001).

<sup>19</sup> See Roberts M. and P. Wehrheim (2001).

## 6 Conclusions

Ukraine's road to WTO accession is as difficult as most other larger countries' roads to Geneva have proven to be. However, the policy objective of joining the WTO is well chosen. The accession would provide numerous economic benefits, which should clearly outweigh several particular adjustment problems in the economy and in legislation. Adhering to the rulebook itself and establishing a WTO-compatible and quite transparent trade regime for goods, farm produce and services is of great benefit to Ukraine as well.

The particular choices in trade strategies should be well considered before accession. Tariff rates and structures, commitments in goods and services, the shape of domestic agricultural policy and of the farm trade regime all have to be considered in this light. Regional considerations play into it as well. There is a good case to be made for starting with a reasonable level of tariff protection in goods, for making broad market access commitments in services and for adjusting agricultural policies quite substantially.

For WTO members, the Working Party and the General Council, the accession of Ukraine should prove a welcome opportunity of demonstrating that complex transition economies can be well integrated into the world trading system and its rules. The use of particular transition periods to bring domestic legislation on non-essential matters into full compliance with WTO rules should be seriously considered. In essential matters such as farm policy and the tariff system, substantial commitments are indispensable, however.

Moreover, and last point, it is not self-evident to me that the current approach of members of the WTO to demand from acceding countries to get by with a very low average level of external protection upon accession is necessarily right in all particular country instances.<sup>20</sup> Germany, for example, had a considerable level of tariff protection right into the 1950s, and in some instances such as the car industry, a 10% tariff rate of the EU still applies today. For some countries negotiating the accession to the WTO, a level of tariff protection more commensurate with their current level of development, level of industrialisation and capacity to economically and socially cope with conditions of freer trade would seem to justify a much greater flexibility on part of the powerful members negotiating tough market access commitments for the new-comers, but only rarely for themselves. One should not lose historical perspective out of sight. Free trade is fine, but getting there might take decades rather than a few years.

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<sup>20</sup> See Lücke M. (1998); Lücke M., R. J. Langhammer (2001).

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## **10 Quantitative Analysis of Implications of Russia's Accession to the WTO**

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This article considers the problem of quantitative measurement of implications of Russia's accession to the WTO. Main attention is focused on the analysis of the impact of expected change in the level of foreign trade duties on dynamics of imports and domestic production. A notion of an "equivalent duty" has been introduced in the article; this notion is a key concept of the proposed methodology of quantitative analysis.

The intense discussion of the issue of accession to the WTO over the recent past has one substantial shortcoming, i.e. the lack of any quantitative assessment of implications of this event for the Russian economy.

The lack of such assessments can be explained, firstly, by the existence of a huge number of non-tariff methods of regulation that are virtually beyond any quantitative assessment. Secondly, it can also be explained by the lack of clear-cut methodology and of the relevant set of instruments, which are necessary for obtaining quantitative assessments of implications of any change in the level of foreign trade tariffs.

It seems impossible to obtain generalized and mutually interrelated assessments of implications of application of different non-tariff methods of foreign trade regulation.

However, it is necessary and quite possible to calculate different scenarios for changes in foreign trade duties and their impact on the national economy. In this connection, the key problem is to understand in what way some specific changes in import duty will affect the scale of domestic production. It goes without saying that it is impossible to give an exact assessment of such an impact. However, in our view, the recent developments (of 1998 -1999 in particular) provide enough

information to measure the extent of impact of changing import duties on dynamics of imports and, consequently, on dynamics of domestic production.

At the same time it is not an easy task to perform this kind of economic measurements. The point is that import duties practically did not undergo any changes in 1998-1999. It is a well-known fact that dynamics of imports in 1998-1999 was affected by a dramatic change of the US Dollar exchange rate rather than by changes in import duties. Nevertheless, the topical task of this study of implications of accession to the WTO is to assess the impact of import duties (not the dollar exchange rate) on economic dynamics.

## **1 Methodology for calculating the equivalent import duty**

It is much easier to accomplish the above-mentioned task if we manage to see that the impact of the US Dollar exchange rate appreciation on economy is to some extent equivalent to the growth of import duties. This is true that both the US Dollar exchange rate appreciation and the growth of import duties bring about the rise of prices on imported products on the Russian market. As a result, imports are reduced and domestic production grows. In addition, in terms of quantity the same correlation of changes in import duties and in the exchange rate has different implications for the growth of consumer prices and, respectively, for the dynamics of imports.

Thus, the task is to determine such quantitative correlation between dynamics of the exchange rate and dynamics of import duties, which, in the end, leads to an identical growth of consumer prices.

In order to make our further thinking and mathematical calculations absolutely clear, let us introduce a new notion of the equivalent duty.

By the equivalent duty we mean such a level of import duty, which, from the point of view of the domestic market protection, is equivalent to a safeguarding effect of depreciation of the national currency exchange rate (specifically, in connection with the developments of 1998-1999).

To calculate the equivalent duty, the following values should be introduced:

1.  $t_t$  – initial customs duty;
2.  $st_t$  – share of initial customs duty in the final consumption price;
3.  $I\$$  - growth index of the nominal US Dollar exchange rate;
4.  $I_p$  – growth price index in economy – in a general case it is equivalent to the GDP deflator;

5.  $k$  – equivalent duty coefficient (index) growth in relation to the initial value of the customs duty;
6.  $E_t$  – equivalent customs duty.

The methodology of calculating the equivalent import duty is sufficiently transparent and makes it possible to calculate such level of the duty, which could provide advancing growth of prices on imported products (relative to the overall growth of prices in economy). It would be equal, in fact, to the advancing growth of prices on imports caused by the dramatic change in the US Dollar exchange rate in 1998-1999.

The formal identity on the basis of which  $k$  coefficient is calculated looks as follows:

$$I\$/Ip = (1-stt) + stt*k; \quad (1)$$

where

$$k = (I\$/Ip*stt) - 1/stt + 1 \quad (2)$$

In formula (1) the expression  $(I\$/Ip)$  showing a correlation of the nominal exchange rate and GDP deflator, in fact, is an indicator of advancing prices on import products. The level of the equivalent duty is a product of the basic import duty and  $k$  coefficient, that is:

$$E_t = tt*k; \quad (3)$$

By using the aforesaid formula and the actual values of the US Dollar exchange rate dynamics and the GDP deflator, it is easy to assess the magnitude of the equivalent duty for different basic values of the import duty. Therefore, with all other conditions unchanged, the change in price proportions in the year of 1998 (we mean the change in correlation between the exchange rate and the GDP deflator)) is equivalent to the following change of import duties.

**Table 10.1**

Basic and equivalent import duties, %

Basic import duty	5.0	10.0	15.0	20.0	25.0	30.0
Equivalent duty	57.1	64.6	72.1	79.6	87.1	94.5
<i>The growth of duty (times)</i>	<i>11.43</i>	<i>6.56</i>	<i>4.81</i>	<i>3.98</i>	<i>3.48</i>	<i>3.15</i>

From here, we can conclude that for products that were subject to a 5% import duty before the events of August 1998, and the US Dollar exchange rate rebound (that followed the events of August 1998) was equivalent to a 11.4-fold increase of the import duty. Therefore, it meant a 3.15-fold increase of import duty for products with a 30% import duty.

At the same time the above-mentioned results are general and very approximate. It is evident that when making such calculations for a specific type of products (or

products group) it is necessary to change the GDP deflator in formula (1) and (2) by characteristics of the growth of prices for the given product or products group. Moreover, if there were direct statistics available on the growth of prices on imported products it would probably be more appropriate to use such data instead of the US Dollar exchange rate growth index.

However, the above-cited calculations are sufficient for assessment of the scale of protection of domestic market (as a result of the ruble devaluation in 1998) for products with different initial level of import duties.

The actual statistical data of 1998-1999 (the period of dramatic changes not only in basic price proportions but also in dynamics of foreign trade) makes it possible to assess both the calculated level of equivalent duties and the economy's response to the changed US Dollar exchange rate and the changed import duties.

If, as a result of developments in the year of 1998, the equivalent duty for some products was 85% instead of initial 25% (i.e. the increase made up 60% percentage points) while imports were reduced by 30%, then import elasticity with respect to the level of duty should be equal to  $(-0.5)$   $(-30/60)$ . In this case we can state that the increase of import duty by 10 percentage points leads to import reduction by 5% and, vice versa, the reduction of import duty by 10 percentage points leads to import increase by 5%.

The assessment of import elasticity dependence on the level of import duties for different products and product groups makes it possible to calculate the initial implications of different scenarios of Russia's accession to the WTO and, in particular, implications in terms of change of import dynamics.

## **2 The methodology of assessing implications of import duty changes for the national economy on the basis of a statistical inter-sectoral model**

The main issue, however, is not just understand how imports dynamics will change as a result of import duty changes but it is more important to determine the macroeconomic implications of these changes. Among all macroeconomic implications, the impact of import duty changes on economic dynamics should probably be studied in the first turn.

Such results can only be obtained on the basis of inter-sectoral model. The inter-sectoral calculations allow assessing such evident implications as import changes and the possible price growth changes in income of economic agents, a change in the level of production and investments into different branches of national economy.

A table of calculated values (on the basis of MOB SNS in current and constant prices over 1997-1999) of the following indicators is given below:

- Equivalent duty;
- Import elasticity (in the above-mentioned meaning) depending on import duty changes.
- As well as elasticity of branch production depending on import changes.

It should also be emphasized a certain methodological difference between the terms of import *elasticity* by duty and production *elasticity* by import. If production *elasticity* by import is classical to a certain degree and shows the percentage by which will change production with change of import by one per cent, import elasticity by duty shows how much will import change with the change of import duty *by one percentage point*. The use of the latter type of elasticity is justified because the change of the initial 5% import duty by one per cent is not very vivid since it presents a 5.05% import duty. The situation with the change of import duty from 5% up to 6% presents a difference.

**Table 10.2**  
Import duties and import and production elasticities

	The average level of import duty, %	The equivalent import duty, %	Import duty elasticity of import	Import duty elasticity of production
	1	2	3	4
Oil production	6	30	-0.54	-0.02
Oil-refining	6	69	-0.47	0.03
Gas industry	6	36	-0.11	-0.01
Coal industry	5	76	0.03	-0.04
Ferrous metallurgy	11	64	-0.56	-0.14
Non-ferrous metallurgy	16	42	-1.79	-0.08
Chemical industry	10	69	-0.20	-0.22
Machine building	21	115	-0.26	-0.29
Forestry and pulp and paper industry	19	59	-0.52	-0.05
Construction and building materials industry	6	67	-0.31	-0.03
Light industry	25	93	-0.23	-2.44
Food industry	45	115	-0.24	-0.67
Agriculture and forestry	17	81	-0.10	-0.07
Other industries	21	73	-0.42	-0.08

Moreover, it should be stressed that production elasticity by import given in Table 10.2 has been on a fixed inter-sectional balance over one year. When making dynamic calculations within the framework of one or another scenario these types



of elasticity are likely to be changing depending on changes in all proportions of economy and, in the first turn, on correlation between import and production. It should be noted that a change in import of production of any industry results in a change of production of all other industries though to a less degree.

Those types of elasticity shown in the table allow to easily determining the implications of import duties' changes by industries. For example, the reduction of import duties in light industry by 10 percentage points will result in reduction of production in this industry by 5.7% ( $-10 \cdot -0.23 - 2.44 = -5.71$ ).

To determine the aggregate change of production as a result of changes of duties for all groups of products, it is sufficient to use the inter-sectoral balance statistics model by putting in the values of imports due to changes in import duties and values of sectoral import elasticity according to import changes.

### **3 Methodology of assessment of implications of changes in import duties as applied to certain products and groups of goods**

The above-mentioned methodology allows us to assess the implications of accession to the WTO for the national economy in terms of aggregated industries and only in the presence of the tables of inter-sectoral balance.

At the same time the development of such balances, traditionally, lags behind by 2 or 3 years, and, then, the nomenclature of inter-sectoral balances elaborated in Russia does not exceed 120 aggregated positions.

In the meantime, the accession to the WTO and a change of import duties become especially important for specific goods groups and certain commodities rather than for big industries.

And if the calculation of import elasticity on changing duty for specific goods can be based on the method of calculating equivalent import duty, as described above, obtaining elasticity assessments of production by import for specific goods presents a specific problem. The exact calculation of this kind of elasticity is possible only in the presence of an inter-sectoral balance of the adequate level of aggregation. A question arises at this point whether it is possible to calculate this kind of elasticity by another method, though maybe not so exact but rather of a good quality.

Our analysis shows that such a calculation is possible but we cannot do without an inter-sectoral balance. Therefore, the advantage of the proposed approach is there is no necessity in building a balance of the high level of aggregation. It is

sufficient to use certain correlations from a traditional balance of ordinary dimensions, for example 25 for 25 industries.

Firstly, attention should be paid to the fact that imports and production of any products are connected by a simple balance correlation where *production = consumption + export-import*.

Thus, *ceteris paribus* with invariable consumption and export, the growth of import per unit results in reduction of production per unit. Out of this correlation it is evident that the increase of import by one per cent results in reduction of production by the value of per cent equal to the share of import in production. This is true by default that production elasticity by import is equal to:

$$\text{elast} = (dX/X)/(dIm/Im) \quad (4)$$

but since

$$dX = dIm \quad (5)$$

(*ceteris paribus* with invariable consumption and export, the growth of import per unit results in reduction of production per unit) and

$$Im = D \cdot X, \quad (6)$$

where

$D$  – a share of import in production, then

$$\text{elast} = (-dIm/X)/(dIm(D \cdot X)) = -D \quad (7)$$

Thus, the share of import in production is  $D$ , then production elasticity by import *ceteris paribus* equals  $-D$ . It means, if the share of import in production equals  $D$ , and import increases by  $Z\%$ , then production reduces by the value equal to  $(D \cdot Z)\%$ . For example, if the share of import in production equals 0,2 and import increases by 10%, then production reduces by 2%.

However, the problem lies in the fact that the change of production as a result of change in imports causes the change in consumption of all types of resources necessary for production of given goods as a result of which it changes consumption of the given product vis-a-vis other products. That is, the existence of inter-sectoral relations, to some extent, changes our easily obtained initial elasticity. The task is to understand the direction and scale of this change.

As regards the direction, it is absolutely evident that elasticity, in its absolute value, is always bigger than the share of import in production. It is true, in case the import of some goods increases by one per cent, production will reduce by the value of import share in production within the framework of our direct balance account. But, in reality, owing to inter-sectoral relations production will reduce by a bigger value, which means exceeding in absolute value of the final elasticity

over the initial one. All this reasoning is easily confirmed by inter-sectoral balances (see Table 10.3). It is easy to see that correlation between the value of elasticity and a share of import in production for different industries is close enough. It allows assuming that there is a good correlation between these two variables.

**Table 10.3**

Export elasticity of production and the share of import in production

	Export elasticity of production	The share of import in production
Oil production	-0.0204	0.0182
Oil-refining	-0.0330	0.0312
Gas industry	-0.0101	0.0098
Coal industry	-0.0400	0.0372
Ferrous metallurgy	-0.1372	0.0902
Non-ferrous metallurgy	-0.0807	0.0517
Chemical industry	-0.2220	0.1681
Machine building	-0.2854	0.2618
Forestry and pulp and paper industry	-0.0527	0.0478
Construction and building materials industry	-0.0252	0.0227
Light industry	-2.4430	2.0051
Food industry	-0.6704	0.4911
Agriculture and forestry	-0.0687	0.0554
Other industries	-0.0787	0.0727

Building of the simplest equation has confirmed this hypothesis.

The obtained equation has the following parameters:

$$\text{elasticity} = -1.2256 \cdot D \quad (8)$$

where

$$R^2 = 0.999$$

$$\text{sey} = 0.012$$

( $R^2$  – a coefficient of determination, sey – a standard parameter error).

The existence of such a close link allows us to adopt a hypothesis that for all goods manufactured in Russian economy the multiplier of inter-sectoral relations, which exceeds the final value of elasticity if compared with the initial one obtained from the balance identity, is close to 1.2256.

Thus, by knowing import elasticity by the duty and calculating production elasticity by import with the help of an equation (8), it is easy to evaluate the impact of import duty change on the production of any specific kind of goods.

## **4 Main scenarios of import duty changes at the moment of Russia's accession to the WTO**

While making calculations two scenarios for tariff changes have actually been used (Table 10.4 and 10.5).

The first and more likely scenario envisages a smooth change from the current level of import duties to the final agreed level of binding them together.

The second scenario, an optimistic one, envisages that we'll be able to agree upon conditions according to which Russia will be allowed to substantially enhance import duties and then, consequently (after seven years) they will be lowered till the final agreed level of binding them together.

The values given in Tables 10.4 and 10.5 are results of aggregated import duties in line with a wide range of nomenclature goods currently discussed during negotiations on Russia's accession to the WTO.

It should be kept in mind that only initial and final duty values have been used within the framework of statistics, whereas within the framework of dynamic calculations there have been used dynamic series of import duties as they are given in the table.

Moreover, when calculating certain groups and groups of goods currently negotiated specific values of import duties for these goods and groups of goods have been used.

## **5 Macroeconomic implications of Russia's accession to the WTO**

The calculations show that even in case of import duty reduction by half (which is not envisaged by any of scenarios of accession to the WTO) the final reduction of production of Russian economy will make not more than 1%.

Therefore, similar calculations with the help of an inter-sectoral model show that recent ruble strengthening has far more stronger negative implications for economic growth than any hypothetical reduction of import duties as a result of Russia's accession to the WTO (Table 10.6).

The aforesaid results made the basis for calculations performed with the help of the macroeconomic inter-sectoral model developed at the Institute of national economic forecasting of the Russian Academy of Sciences. Series of the averages in the industry import tariff have made up the basis for calculations given above in

**Table 10.4**

Scenario of a smooth change of import duties if compared with their initial level

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Oil-refining	0.050	0.050	0.050	0.050	0.050	0.050	0.050	0.050	0.050	0.050
Coal industry	0.050	0.050	0.050	0.050	0.050	0.050	0.050	0.050	0.050	0.050
Ferrous metallurgy	0.161	0.155	0.149	0.143	0.137	0.131	0.125	0.119	0.113	0.107
Non-ferrous metallurgy	0.069	0.070	0.070	0.071	0.072	0.072	0.073	0.073	0.074	0.075
Chemical industry	0.081	0.079	0.078	0.076	0.075	0.073	0.072	0.071	0.069	0.068
Machine building	0.187	0.190	0.192	0.195	0.198	0.201	0.204	0.207	0.209	0.212
Forestry and pulp and paper industry	0.160	0.157	0.155	0.152	0.149	0.147	0.144	0.141	0.139	0.136
Construction and building materials industry	0.050	0.050	0.050	0.050	0.050	0.050	0.050	0.050	0.050	0.050
Light industry	0.221	0.217	0.213	0.210	0.206	0.202	0.198	0.194	0.191	0.187
Food industry	0.355	0.347	0.340	0.333	0.326	0.319	0.311	0.304	0.297	0.290
Agriculture and forestry	0.141	0.160	0.179	0.198	0.216	0.235	0.254	0.273	0.292	0.311
Other industries	0.209	0.206	0.203	0.200	0.197	0.193	0.190	0.187	0.184	0.181

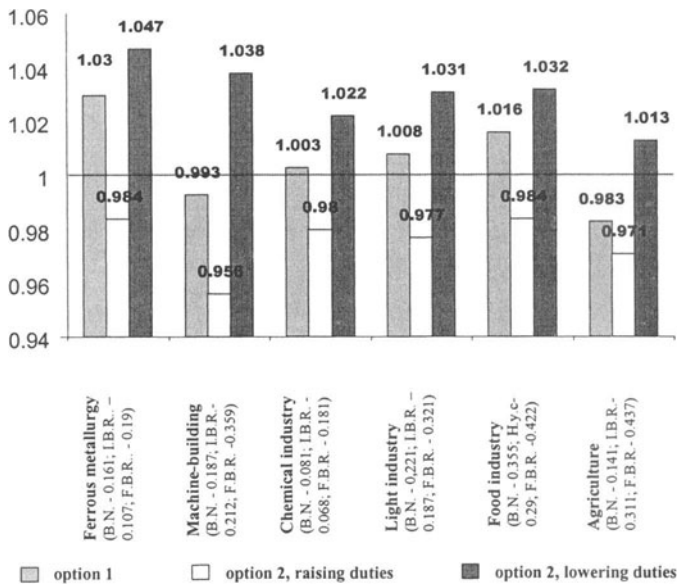
**Table 10.5**

Optimistic scenario that envisages a substantial increase of import duties in 2003

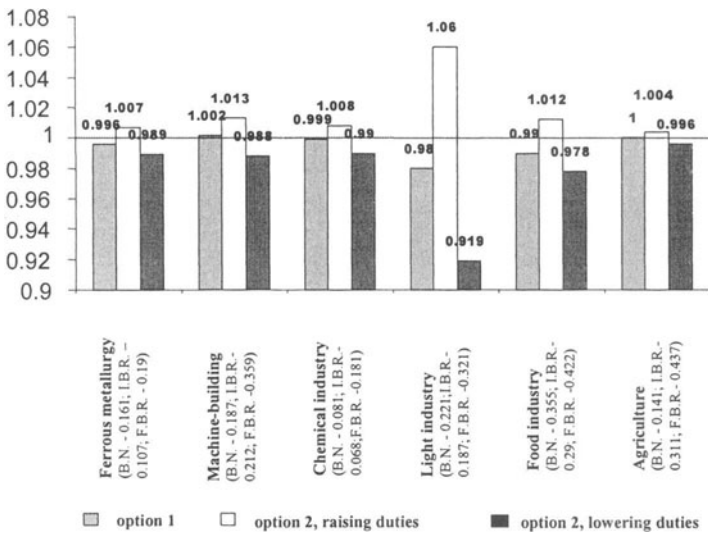
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Oil-refining	0.050	0.050	0.139	0.126	0.114	0.101	0.088	0.075	0.063	0.050
Coal industry	0.050	0.050	0.059	0.058	0.056	0.055	0.054	0.053	0.051	0.050
Ferrous metallurgy	0.161	0.161	0.190	0.178	0.166	0.154	0.143	0.131	0.119	0.107
Non-ferrous metallurgy	0.069	0.069	0.120	0.113	0.107	0.101	0.094	0.087	0.081	0.075
Chemical industry	0.081	0.081	0.181	0.164	0.148	0.132	0.116	0.100	0.084	0.068
Machine building	0.187	0.187	0.359	0.338	0.317	0.296	0.276	0.254	0.233	0.212
Forestry and pulp and paper industry	0.160	0.160	0.184	0.177	0.170	0.163	0.157	0.150	0.143	0.136
Construction and building materials industry	0.050	0.050	0.059	0.058	0.056	0.055	0.054	0.053	0.051	0.050
Light industry	0.221	0.221	0.321	0.302	0.283	0.264	0.245	0.223	0.204	0.187
Food industry	0.355	0.355	0.422	0.403	0.384	0.367	0.346	0.327	0.309	0.290
Agriculture and forestry	0.141	0.141	0.437	0.419	0.401	0.383	0.365	0.347	0.329	0.311
Other industries	0.209	0.209	0.350	0.326	0.302	0.278	0.254	0.233	0.204	0.181



**Figure 10.1**  
Impact of import duties' changes on import and volumes of production by industries\*

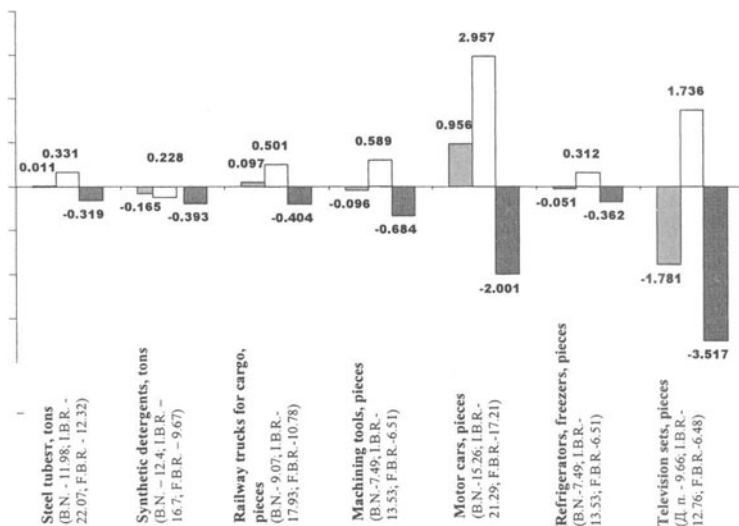


**Figure 10.2**  
Impact of import duties' changes on volumes of production by industries\*

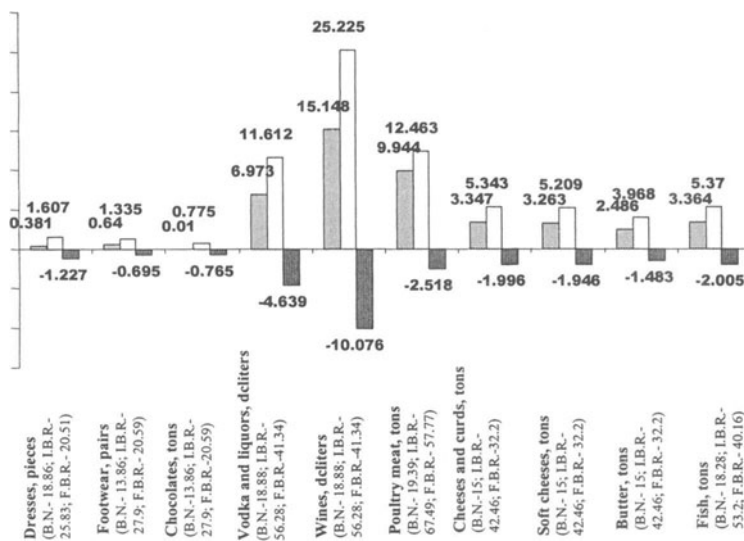


**Figure 10.3**

Impact of import duties' changes on volumes of import by products, %\*

**Figure 10.4**

Impact of import duties' changes on volumes of import by products, %\*



\* Note: B.N. - before accession negotiations, I.B.R. - initial bound rate, F.B.R. - final bound rate.



# 11 Implementation of WTO Regulatory Rules in Ukraine: Challenges and Opportunities<sup>21</sup>

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Membership in the WTO will require Ukraine to reform its domestic regulatory environment, in addition to constraining its choice of trade policies. Implementing these regulatory reforms will cost money and take time. This paper assesses administrative costs of implementing WTO rules governing intellectual property rights, food safety, and industrial product standards.

## 1 Introduction

Joining the World Trade Organization (WTO) constrains a government's freedom to set formal trade policies, such as customs duties or quantitative restrictions on goods as they cross borders. Membership also exposes members to rules affecting domestic regulations that affect trade. This chapter addresses the challenges facing Ukraine as it makes commitments in this second area. I argue that these challenges represent more than a commitment to change policies, but instead a commitment to undertake significant investments in legal reforms, administrative reorganisation and capacity building. Such measures take time and cost money. Furthermore, the economic benefits of complying with WTO regulatory rules are by no means guaranteed; other institutional reforms are necessary for Ukraine to benefit fully from compliance. This chapter presents rough estimates of

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<sup>21</sup> The findings, interpretations, and conclusions expressed here are those of the author and do not necessarily reflect the views of the Board of Executive Directors of the World Bank or the governments they represent. An earlier version of this paper was presented on December 12, 2002, in Kyiv at the conference "Ukraine's WTO Accession: Challenges for Domestic Economic Reforms," sponsored by the Institute for Economic Research and Policy Consulting in Ukraine and the German Advisory Group on Economic Reform.

administrative costs, based on experiences of several comparator countries, and suggests additional measures that the Ukrainian government will need to give commercial value to WTO rules.

A brief historical detour sets the stage for our examination of implementation costs. During the first quarter-century of multilateral trade negotiations conducted under the General Agreement on Tariffs and Trade (GATT), negotiators concentrated their attention on import tariffs, export subsidies, and quantitative restrictions — explicit trade policy instruments applied on goods as they cross a border. Starting with the Tokyo Round, the trade agenda expanded to include new issues such as counterfeit goods, government procurement, and customs valuation procedures. The Uruguay Round witnessed further broadening of the multilateral trade agenda: members agreed to binding commitments on intellectual property rights, standards, customs valuation, trade-related investment measures, domestic subsidies, and regulations affecting trade in services. Since the Uruguay Round there have been discussions on expanding the agenda still further to include labor and environmental regulations as well as competition (anti-trust) policies and broader investment measures.

These new issues address international trade barriers that are created “behind the border” by government regulations. As with traditional trade policies (i.e., barriers applied at the border) cumbersome regulations can be used as tools to protect domestic companies from foreign competition. For example, many countries impose overly restrictive technical standards or duplicative testing requirements to block imports. These are worse than protective tariffs from the standpoint of economic welfare, because firms as well as the government must devote scarce resources solely to comply with protectionist domestic regulations—often in the form of skilled personnel and specialized equipment that could be used far more productively in other sectors of the economy.

A second reason these behind the border barriers are important is that *eliminating* them is costly. Unlike tariff liberalisation, eliminating regulatory barriers is not “self-implementing.” Although it is certainly *politically* costly for a government to undertake tariff reductions, implementing the new policy is essentially costless: with the stroke of a pen, the tariff rate is changed, which in turn changes the relative prices of goods in the market, leading to reallocation of resources within the economy. Implementing WTO rules on trade-related regulations also affects the flow of goods in the market, but doing so requires more than simply removing a policy distortion. Compliance requires the government of Ukraine to train staff, buy equipment, rewrite laws, and reorganize government agencies, and much more.

Finally, WTO disciplines on domestic regulations are important because, in most developing and transition economies, the economic benefits of compliance are not guaranteed. Again, this differs from traditional trade liberalisation. Absent significant market failures, an economy as a whole is ultimately better off when its

government reduces tariffs, quotas, or export subsidies, and net economic welfare increases at the world level when all countries collectively liberalize these barriers. In contrast, when all countries—rich and poor—undertake legal reform to increase intellectual property rights protection, to take one example, the initial impact is purely redistributive: rents are transferred from consumers in poor countries to patent and copyright holders in rich countries, without any associated increase in global economic welfare. Enforcement of stronger intellectual property rights protection *can* stimulate greater investment in new ideas, and therefore long-run economic growth, only in the presence of ancillary institutions such as well-functioning venture capital markets, networks that connect inventors with investors, effective contract-enforcement and the rule of law, and collection societies that channel payments from rights users to rights owners. Similar arguments apply to other areas of regulatory reform, although the redistributive impact of TRIPS is the most striking.

This chapter attempts to estimate how much Ukraine might need to spend on implementing WTO agreements in ways that advance its economic welfare. The method I use to arrive at these estimates is to review other countries' experiences making reforms similar to those that Ukraine will need to undertake, relying primarily on past capacity building projects in three areas.<sup>22</sup>

- Intellectual property rights, as defined in the Agreement on Trade-related intellectual property rights (TRIPS).
- Industrial product standards, as governed by the Agreement on Technical Barriers to Trade (TBT).
- Food, plant and animal safety regulations, which are covered by the Agreement on Sanitary and Phytosanitary Standards (SPS).

Finally, I will return to Ukraine and outline some specific areas where additional measures are needed to give commercial value to WTO rules.

Implementation simply to comply with WTO regulatory rules costs money. Implementation that makes development sense costs even more. The development challenge facing Ukraine is to invest in the necessary government capacity and complimentary institutions so that WTO compliance yields economic benefits for the country. Making these investments can help complete Ukraine's transition to a market economy.

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<sup>22</sup> This paper follows the methodology used in J. Michael Finger and Philip Schuler, "Implementation of Uruguay Round Agreements: The Development Challenge," *World Economy* 23 (April 2000), pp. 511–525.

## 2 Intellectual property rights

Intellectual property rights protection is perhaps the most contentious regulatory issue on today's international trade agenda. American and Western European criticisms of Ukraine's copyright regime constitute a principal obstacle to its WTO accession. These criticisms persist even though the Ukrainian legislature has already rewritten countless laws in recent years to bring them into correspondence with international intellectual property rights treaties.<sup>23</sup>

The TRIPS agreement requires WTO members to provide effective protection for patents, trademarks, copyrights, integrated circuits, trade secrets, and geographical indications. As with other WTO agreements, TRIPS requires transparency, national treatment and non-discrimination in the application of intellectual property rights.<sup>24</sup> More specifically, the TRIPS agreement requires WTO members to provide minimum levels of protection, as outlined in the major intellectual property rights conventions.<sup>25</sup> The enforcement provisions of the TRIPS agreement require that WTO members provide civil and criminal remedies for infringement of intellectual property rights. They also obligate members to provide means by which rights holders can obtain cooperation of customs authorities to prevent imports of infringing goods. Effective management of intellectual property rights also requires efficient administration of patent, copyright and trademark offices. Such requirements place few demands on advanced industrial countries, since TRIPS and other intellectual property rights conventions essentially codify these countries' existing standards and practices. In contrast, Ukraine and other transition countries must rewrite laws and upgrade patent and copyright office operations in their efforts to comply with the TRIPS agreement.

Will these measures advance economic development in Ukraine? Intellectual property rights are intended to strengthen incentives for investment in knowledge-

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<sup>23</sup> In an April 2001 report submitted to the WTO as part of accession negotiations, the government listed 29 laws then in force that formed the current intellectual property rights regime and 22 additional draft laws needed to bring existing rules into compliance with TRIPS. "Accession of Ukraine: Memorandum on the Implementation of Trips," WT/ACC/UKR/94 (April 11, 2001).

<sup>24</sup> "National treatment" means that foreign products or suppliers are treated no less favorably than domestic ones. Non-discrimination, also called "most-favored nation" treatment, refers to treating one WTO member no less favorably than others.

<sup>25</sup> These include, among others, the Paris Convention on patents, Berne Convention on copyrights, and the Rome Convention on performers' rights. One critic complains that "these [are] not 'minimum' standards of intellectual property protection in the classical sense of the term; rather, they collectively expressed most of the standards of protection on which the developed countries could agree among themselves," Jerome H. Reichman, "Securing Compliance with the TRIPS Agreement after US versus India," *Journal of International Economic Law* 1 (December 1998), p. 586.

intensive industries in a decentralized market economy, given the externalities that exist with the development of new ideas.<sup>26</sup> But strengthening intellectual property rights protection is not a sufficient condition for such investment.<sup>27</sup> Creating this incentive also depends on the existence of well-functioning capital markets, effective contract enforcement, and other complementary institutions. Building those institutions in Ukraine will take some time.

In the meantime, introducing stronger intellectual property rights protection through the TRIPS Agreement leads to a transfer of rents from Ukraine to other countries, in the form of licensing fees, royalties and higher prices paid by consumers for products protected by patents and copyrights. This transfer is quite substantial. The Washington-based International Intellectual Property Alliance (IIPA), a special interest group representing copyright holders, estimates that stronger copyright protection in Ukraine would generate an additional USD 250 m of revenues each year for its members. The IIPA estimates that American software and entertainment companies would earn an additional USD 20 bn from TRIPS compliance worldwide.<sup>28</sup> The World Bank *Global Economic Prospects* estimates that the full application of TRIPS worldwide will result in a net rent transfer of USD 35 bn annually to the top six patent-holding countries from consumers in the rest of the world.<sup>29</sup>

In the long run, stronger intellectual property rights protection should help increase economic growth by facilitating investment in innovation and creativity. To introduce stronger protection, governments need to invest in the capacity to

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<sup>26</sup> The core economic problem is that once a new idea is revealed, others can benefit from the knowledge without paying the person or company that created the knowledge. This weakens the economic incentive to invest in innovation. A patent or copyright attenuates the market failure by granting the innovator a temporary (and tradable) monopoly right

<sup>27</sup> Nor are intellectual property rights a necessary condition for investment in new ideas. Direct public funding of research and the arts is one way to overcome the externality, and prizes often serve as an incentive in place of granting monopoly rights. The most famous example of the latter is the prize that the English Parliament established in 1713 for the invention of a chronometer—a device that permitted precise measurement of longitude and thereby facilitated ocean navigation. Christine MacLeod argues that industrial organisation critically determines whether firms rely on patents or other measures to internalize the benefits of innovation. Christine MacLeod, *Inventing the Industrial Revolution: The English Patent System: 1660–1880*, (Cambridge: Cambridge University Press, 2002).

<sup>28</sup> International Intellectual Property Alliance, “2002 Special 301 Report: Ukraine” (Washington: February 2002) Available at <http://www.iipa.com/rbc/2002/2002SPEC301UKRAINE.pdf>.

<sup>29</sup> World Bank, *Global Economic Prospects*, 2002 (Washington: World Bank, 2002), chapter 6. These six countries are US, Germany, Japan, France, U.K., and Switzerland. There is a wide confidence band around the point estimates of rent transfers.

administer these intellectual property rights effectively. To get a sense of the likely cost to Ukraine, I turn to a brief review of intellectual property rights-related development projects in several large middle-income developing countries (Mexico, Indonesia and Turkey). These projects were designed to improve intellectual property rights protection as one means of advancing broader economic development objectives (such as industrial increasing research and development); they were not designed solely to bring these countries into compliance with the TRIPS agreement or any other international convention. These projects reveal a considerable range of areas where developing and transition country governments needed to introduce reforms: drafting new legislation, (e.g., to extend intellectual property rights protection to plant varieties, integrated circuits, trade secrets), creating new agencies, augmenting administrative structures (e.g., capacity to review applications, including computerized information systems and extensive training for staff) and buttressing enforcement. The technical complexity and specificity of many intellectual property rights issues means that judges, customs officials and others involved in enforcing intellectual property rights often require additional training. That complexity also means that the government should mount an extensive public education campaign to inform inventors about their rights and how to defend them. Table 11.1 below shows the administrative start-up costs of intellectual property projects in Mexico, Indonesia and Turkey that one might take as examples of what Ukraine can expect to spend to finish introducing world-class intellectual property protection.<sup>30</sup>

**Table 11.1**  
Intellectual property projects

Country	Project Components	Cost	Duration
Mexico	Train patent office staff	USD 32.1 m	1992–1996
	Automate patent office procedures		
Indonesia	Draft new copyright laws and regulations	USD 14.7 m	1997–2003
	Draft new patent laws		
Turkey	Reorganize patent office	USD 19.3 m	1997–present
	Public education campaign		

Sources: World Bank project documents

Creating an effective regulatory environment to enforce intellectual property rights is no small task. It adds up to around USD 30–50 m over five or six years.<sup>31</sup>

<sup>30</sup> These are components of World Bank loans that also contained much larger components funding industrial research and development.

<sup>31</sup> This addresses transitional activities in the administration of patents and copyrights: establishing or restructuring agencies and writing laws. Once in existence, a well-functioning patent or copyright office should support itself through fees collected with patent registrations.

Procuring equipment for patent, trademark and copyright automation in particular can be very expensive. The final cost to Ukraine could easily exceed what Mexico and others paid because Ukraine did not inherit a legacy of private property rights and market institutions when it set out to develop intellectual property rights protection. The Ukrainian government's job of constructing a new regulatory apparatus to administer intellectual property rights must be supplemented by reforms in other areas, especially financial markets, in order for stronger intellectual property rights to function as an effective incentive for investment in creativity and new technologies. Technological change occurs in capitalist economies through creative destruction: new firms with new technologies enter the market while unsuccessful firms exit, releasing their assets (including intellectual property assets) for new uses by remaining companies. To realize the promise of TRIPS, Ukraine must reform laws on joint stock companies, collateral, bankruptcy, and asset stripping to improve the working of capital markets, in addition to strengthening intellectual property rights regulations.

### 3 Industrial standards and regulations

It is estimated that 80% of world trade is affected by technical regulations and standards.<sup>32</sup> The goal of WTO Agreement on Technical Barriers to Trade (TBT) is to reduce the adverse effects that these can have on international trade. The TBT agreement requires that WTO members commit to applying technical regulations fairly and transparently: regulations must not discriminate by country of origin, foreign products must be treated no less favorably than domestic ones, and members must notify others of proposed regulatory changes, allowing other WTO members the opportunity to comment. The agreement encourages harmonisation of regulations across countries—members are supposed to adopt international standards wherever possible.<sup>33</sup> It also exhorts governments to adopt technical regulations that impose the least possible restrictions on international trade, though in practice it appears that the WTO standards agreements are legitimizing ever stricter standards.

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<sup>32</sup> This estimate is frequently cited in press releases by the US National Institutes for Standards and Technology. See for example the press release announcing the launch of the international measurement database, NIST99-18 (December 2, 1999), available at [http://www.nist.gov/public\\_affairs/releases/n99-18.htm](http://www.nist.gov/public_affairs/releases/n99-18.htm), and NIST's *Technology at a Glance* (Fall 2002).

<sup>33</sup> The WTO itself does not set these standards. A large number of other bodies are involved in establishing standards.

A technical standards regime can be either market-enhancing or market-restricting.<sup>34</sup> Standards help markets work more efficiently by solving information problems. They provide coordination between suppliers and producers about the nature of a product, and they provide information to consumers about the nature of the product, especially safety and, when this is not readily apparent. But they can just as easily be used to reinforce monopoly power (e.g., Microsoft and its Windows operating system) and as a tool of trade protectionism—overly stringent regulations or certification requirements often hurt foreign producers more than domestic ones. Information coming out of Ukraine’s WTO accession negotiations contains many complaints by WTO members about overly restrictive technical regulations in Ukraine.<sup>35</sup> A frequent rebuttal is that these regulations are applied to foreign and domestic firms without partiality, and are therefore WTO-compliant. This simply hurts both domestic and foreign firms, of course, which is not the sort of national treatment trade negotiators had in mind when they drafted the TBT agreement.

WTO rules require liberalizing technical regulations only as they apply to imports. From the perspective of transition to a market economy, a sensible implementation of the TBT agreement affects more than imports, however. Standards are particularly important in production of technologically sophisticated goods. Building a certification system that is recognized by other countries will increase Ukraine’s competitiveness in world markets. Building a market-oriented standards regime will support Ukraine’s industrial development.

What will it take to build such a regime? A review of technical standards development projects in middle-income developing countries reveals a wide variety of reforms needed to bring their domestic standards regimes closer to world-class levels. The measures include the following.

- administrative reorganisation: separate accreditation bodies from certification and standardisation organisations;<sup>36</sup> create a WTO enquiry point; improve personnel management in regulatory agencies;

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<sup>34</sup> The term “technical standards regime” used here encompasses formal laws, normative acts, and government agencies as well private institutions and procedures governing technical standards, whether these are mandatory or voluntary. WTO parlance restricts the term “technical regulations” to denote mandatory standards while “standards” is used to denote only voluntary codes. This is not a convention in the standards literature, however, and standards that are voluntary from the standpoint of public policy are frequently a practical necessity for commercial success.

<sup>35</sup> See the EU’s database of market access barriers at <http://mkacddb.eu.int/>; the latest US report on foreign trade barriers is at <http://www.ustr.gov>.

<sup>36</sup> “Standardisation” refers to the process of developing new standards and technical regulations. “Conformity assessment” refers to the testing (by the manufacturer or a third party) to verify that a product meets the relevant standards. “Accreditation” is the process of auditing conformity assessment providers (e.g., a laboratory), to ascertain whether they are conducting tests appropriately. Close cooperation between



- legal reforms: harmonize domestic regulations with international standards; rewrite laws on standardisation, conformity assessment and accreditation;
- capacity building: procure specialized laboratory equipment; train staff;
- public education and extension services.

Table 11.2 below lists some measures undertaken in standards development projects during the 1990s in Turkey, Russia, and Indonesia.

**Table 11.2**

Technical standards projects

Country	Project	Cost	Duration
Turkey I	Construct facilities, procure equipment and train staff at metrology and quality campus		
	Reorganize management of standards institute	USD74.2 m	1991–1997
	Establish independent accreditation organisation		
Indonesia	ISO9000 (quality management) extension services	USD 5 m	1995–2001
	Establish WTO enquiry point		
Russia	Harmonize standards	USD 34 m	1996–1999
	Gain international accreditation		
	Procure metrology equipment		
Turkey II	Reorganize management of metrology institute	USD 42.5 m	1999–present

Source: World Bank project documents

Based on the experiences of comparator countries, establishing a WTO enquiry point, harmonizing regulations, conducting public education and extension campaigns can be expected to cost in excess of USD 40 m and take four or five years to complete. In addition, it can cost over USD100 m to constructing and equipping metrology facilities, which provide the basic measurement information that testing laboratories depend on.

What has Ukraine accomplished thus far and what remains to be done? The government has publicly committed itself to harmonizing its technical standards regime with that of the European Union. The Verkhovna Rada of Ukraine has already passed a number of new laws governing accreditation, standardisation and conformity assessment. In 2002 the government formally separated the accreditation agency from the state committee overseeing standardisation and

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standards development and conformity assessment bodies often yields benefits. Accreditation auditors should be kept at arms length from other parties, on the other hand.

certification. This body is now seeking to join European Accreditation as one step towards gaining recognition in Western Europe for tests conducted in Ukrainian laboratories. The State Committee on Technical Regulations and Consumer Protection is in the process of adopting EU technical directives as Ukrainian technical regulations.<sup>37</sup> Officials informed the author that approximately 2,500 regulations needed to be harmonized.<sup>38</sup> This has proven to be an exceptionally slow process—regulations need to be translated, circulated among affected government agencies, and then submitted to the Council of Ministers of Ukraine for approval. The handful that had been processed before president recently replaced the cabinet had to be returned to the agencies for resubmission.

Some of the measures needed to implement the TBT agreement are in place, but more remains to be done to create a technical standards regime that will help markets work more efficiently. First, while the government is in the process of harmonizing the *content* of its technical standards with those of international standards, it must also reform the *process* by which manufacturers comply with those standards to gain the full economic benefits of standards harmonisation. Ukraine's present technical standards regime relies almost entirely on mandatory certification: virtually all products are obliged to meet standards set in technical regulations and, furthermore, to employ third-party testing to show that the product does in fact comply with the standards.<sup>39</sup> In contrast, the vast majority of standards in the US and Western Europe are voluntary.<sup>40</sup> The GOU must take care that, in the process of standards harmonisation, it does not transform the body of voluntary international standards into mandatory technical regulations.

Second, a market-enhancing standards regime requires the presence of a legal and judicial environment capable of settling product liability claims quickly, fairly and transparently. A recent study of Ukraine's technical standards regime highlights out a number of deficiencies in the present product liability environment.<sup>41</sup> In

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<sup>37</sup> Texts of draft normative acts that the author reviewed were essentially translation of EU directives into Ukrainian, replacing references to the EU with references to Ukraine.

<sup>38</sup> These interviews were conducted in May and December 2002.

<sup>39</sup> The government has been reducing the scope of mandatory certification as part of WTO accession negotiations.

<sup>40</sup> The biggest exception to this generalisation involves military procurement specifications, which represent the bulk of mandatory standards in the US (National Research Council, *Standards, Conformity Assessment and Trade Into the 21st Century*, Washington: National Academy Press, 1995). These "milspecs" are widely criticized for raising the cost of goods procured by the military and slowing the adoption of commercial technologies. During the first Persian Gulf War, many US military personnel purchased commercial global positioning system devices directly from electronics stores because these were cheaper than and superior to those procured officially by the Pentagon.

<sup>41</sup> Helmut Reihlen, "Report on Standardization and Conformity Assessment in Ukraine," mimeo, World Bank, April 28, 2000.

particular, it points out that the draft product liability law introduces even greater bureaucratic control over the economy rather than providing legal liability: the draft law defines a “defective” product as one that fails to satisfy existing government normative acts, instead of defining defective in terms of failing to perform as advertised. The law thereby presupposes that the government has written a technical standard before a new product may legally enter the market. It furthermore presumes that compliance with all standards is mandatory.

Finally, the provision of conformity assessment services is plagued by monopolisation. The absence of competition is pervasive in most post-socialist economies, and the market for conformity assessment services (testing and certification) in Ukraine is no exception. The government is attempting to address one pathology of monopolies—higher prices—by establishing a committee that will regulate the level of fees that providers charge companies for testing and certification. This is only a short-run solution, however. In the long-run, greater competition is needed through the entry of new providers.

## **4 Sanitary standards for food, plants and animals**

Most, if not all, countries have laws governing food, plant and animal hygiene, and just as many countries accuse others of applying such laws to protect domestic incomes of domestic producers rather than public health. The Uruguay Round introduced new rules to impose disciplines on national laws in those areas. As with other WTO agreements, the Agreement on Sanitary and Phytosanitary Standards (SPS) requires WTO members to apply their laws transparently, without discrimination between different exporting countries, and treating imported products no less favorably than domestic products. According to accounts of Ukraine’s accession negotiations, WTO members frequently complain about onerous government regulations (e.g., rules on meat inspections). The response is typically that these meet conditions of national treatment, transparency and nondiscrimination and are therefore WTO-compliant. As with technical regulations, this is a “fairness” that hurts foreign and domestic firms alike, and is not the sort of national treatment that those drafting the SPS Agreement had in mind. In addition to the standard clauses on transparency and fairness, the SPS agreement also requires that members:

- base regulations on principles “sound science” and existing international standards;<sup>42</sup>

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<sup>42</sup> The WTO does not set these standards, but instead recognizes rules established by the Codex Alimentarius Commission, the International Office of Epizootics and the International Plant Protection Convention.

- introduce hazard control and risk-assessment procedures;
- recognize the concept of disease- and pest-free areas;
- write SPS rules that impede trade flows to the minimum extent possible (without sacrificing national health objectives); and
- establish enquiry points and notify other WTO members of proposed new regulations.

These points imply the need for governments to devote legal, administrative and scientific resources to rewriting laws, establishing new regulatory oversight bodies, outfitting laboratories and pest control facilities, and expanding of agricultural extension activities. One should not infer from these comments that the SPS agreement is onerous, but rather that implementing it is not a costless exercise.

On its surface, the SPS agreement appears to favor developing countries (especially food exporters) at the expense of advanced industrial countries, where consumers have been most successful introducing restrictive food safety laws: the agreement seemingly blocks importing countries from imposing arbitrary and capricious food safety rules at the border. In practice, however, the SPS agreement seems to be contributing to a 'race to the top' in food safety regulations.<sup>43</sup> The agreement explicitly recognizes certain international agreements establishing food safety rules, which generally codify the generally stricter standards developed by OECD countries. Those standards are presumed to be already SPS-compliant, while other countries face the burden of proving that theirs are also compliant. Meeting importing countries' standards requires exporting countries to upgrade their systems for disease control and prevention.

For Ukraine to effectively use the SPS agreement to defend its export rights or justify its import restrictions, it must upgrade its SPS systems to international standards. As in the cases of TBT and TRIPS, effective use of the WTO agreements depends on extensive investments: it is not a matter of applying existing systems of standards to international trade, but a broader matter of installing world-class systems.

The administrative cost of improving SPS regimes obviously depends on nature of the country's agricultural industries and exposure to pests. Development projects addressing SPS measures that were available for review generally address two main issues: sanitary food processing and pest control. While these projects did

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<sup>43</sup> See for example Tsunehiro Otsuki, John S. Wilson, and Mirvat Sewadeh, "Saving Two in a Billion: Quantifying the Trade Effect of European Food Safety Standards on African Exports," *Food Policy* v26, n5 (October 2001): 495-514; Tsunehiro Otsuki, John S. Wilson, and Mirvat Sewadeh, "What Price Precaution? European Harmonisation of Aflatoxin Regulations and African Groundnut Exports," *European Review of Agricultural Economics* v28, n3 (September 2001), pp. 263-283.

not contain programs for standards harmonisation and transparency provisions of the SPS agreement, it seems reasonable to expect that the cost of revising laws and creating an enquiry point for SPS measures will be similar to that seen in technical standards modernisation projects described above.

Projects in developing countries to eradicate diseases after they've broken out have consumed hundreds of millions of dollars. Argentina spent USD 150 m per year during the early 1990s to eliminate foot and mouth disease and thereby enable the ranchers to export fresh beef to the US and Western Europe.<sup>44</sup> Algeria spent USD 112 m in 1988–90 to fight a plague of locusts.<sup>45</sup> Preventing future outbreaks is somewhat less expensive, and involves improving quarantine facilities, vaccination programs, capacity building, improving veterinary and agricultural extension services, and public education campaigns. Table 11.3 below lists pest control and prevention components of some agricultural export promotion projects.

**Table 11.3**  
Pest prevention and control projects

Country	Project	Cost	Duration
Madagascar	Livestock vaccination campaign as part of meat export promotion	USD 11.8 m	1980–88
Brazil	Modernisation of quarantine facilities	USD 108 m	1987–94
	Recruit and train staff for animal health services		
Turkey	Modernisation of laboratories for residue control	USD 3.3 m	1992–99
	Modernisation of quarantine facilities and veterinary diagnostic laboratories;		
China	Purchase equipment for vaccine distribution system	USD 76 m	1993–?
	Technical assistance for animal health and production		

Source: World Bank project documents

Sanitary standards are often stricter for more processed, higher value-added food products. Exporting countries need to certify that meat, fruit, plants, etc., are processed under sanitary conditions to meet requirements set by importing countries. A number of transition countries implemented projects during the early 1990s to improve slaughterhouse and other food processing facilities. These projects attempted to upgrade physical facilities, purchase spare parts, introduce

<sup>44</sup> “Beef Exports Are Back,” IDBAmérica (August 1997). This “elimination” was short-lived—trade was halted a few years later when foot and mouth disease resurfaced in Argentina.

<sup>45</sup> World Bank, Project Completion Report: Algeria Locust Control Program, Report No. 11849 (May 5, 1993).

new packaging technologies, improve hygiene, streamline post-harvest processing to reduce waste, and so on, and are listed in Table 11.4 below.

**Table 11.4**

Food processing projects in Eastern Europe

Country	Project	Cost	Duration
Hungary	Slaughterhouse modernisation to meet foreign standards	USD 41.2 m	19??
Russia	Purchase equipment and inputs to improve food storage and processing, thereby reducing dependence on imported food	USD 150 m	1992–97
Poland	Modernize food processing facilities to improve productivity and compete in foreign markets	USD 71 m	1990–??

Source: World Bank project documents

A final example is the program that Argentina undertook in the early 1990s to promote meat and other agricultural exports. This program was funded in part by loans from the Inter-American Development Bank and the World Bank. The total cost of the World Bank's projects was USD 82.7 m, spread over five years. This project's principal objective was to help Argentine exporters meet US and Western European sanitary standards. The project included measures to:

- upgrade veterinary services;
- improve laboratories and quarantine stations;
- expand training, facilities and equipment for quality control and to certify absence of chemical residues; and
- strengthen procedures to certify that products came from disease- and pest-free zones.

This last point was perhaps the most critical element of the effort to meet importing country regulations. For decades, Argentina's agricultural exports have been limited by the presence of citrus canker and foot and mouth disease in Argentina.

What do these projects imply for Ukraine? Although none of the SPS projects included legal harmonisation components, it seems reasonable to assume SPS harmonisation and establishing transparency procedures will cost roughly the same as similar TBT procedures—roughly USD 40 m. These projects do contain measures to establish other parts of a regulatory environment that would permit Ukraine to defend its domestic regulations from challenges by other WTO members, as well as allow Ukrainian producers meet those countries' import requirements. Based on figures for components of development projects in other agriculture exporting countries, this could cost USD 100–200 m over half a

decade. One should recognize that these measures may be necessary to meet or challenge WTO obligations, but they are by no means sufficient for generating export revenue from the agricultural sector. Ukraine faces more fundamental problems, such as laws governing private land ownership, local government controls over markets, access to credit, and the like. Without improvements in those areas, SPS-compliant regulations may be of little value.

## 5 Challenges facing Ukraine

Let us now summarize the challenges Ukraine faces in implementing WTO regulatory rules. These rules reflect the economic development experiences of OECD economies and the institutions that evolved there over centuries. For OECD countries, implementing the TRIPS, SPS and TBT agreements demands little more than applying their existing laws fairly at the border. (The same holds true for agreements on government procurement or customs valuations.) In contrast, Ukraine inherited a completely different regulatory infrastructure from the USSR. In some cases, the old regime is antithetical to WTO agreements (and vice versa): the GOST standards regime was designed to support and reinforce central planning directives, and its persistence during transition creates a barrier to the introduction of new technologies. In other cases, WTO regulatory rules simply had no analogue in a command and control economy: there is no need to specify intellectual property rights as an incentive for investment in a world where the state owns all property and makes all investment decisions. In either case, the Ukrainian government must now introduce new regulatory regimes that meet the standards of capitalist economies. Doing so requires administrative reorganisation, capacity building, and equipment procurement.

How much will these measures cost? Based on what other countries spent to upgrade intellectual property rights and standards regulations, this will amount to several hundreds of millions of dollars.<sup>46</sup> That covers only three WTO agreements: TRIPS, TBT, and SPS. Ukraine faces additional implementation obligations in the area of customs reform, liberalisation of services trade, trade-related investment regulations, and the like. Is this amount large or small? It is of the same order of magnitude as what Ukraine presently receives in foreign aid and what the government budgets for capital improvements. In 2000 Ukraine received USD 241 m in technical cooperation grants and USD 299 m in other grants.<sup>47</sup> That same

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<sup>46</sup> This understates what comparator countries actually spent because it includes only World Bank projects and leaves out money from other multilateral banks, bilateral donors, and governments' own tax revenues.

<sup>47</sup> World Bank, *Global Development Finance*, 2002 (Washington: World Bank, 2002). Total disbursements that year from the IBRD were USD 113 m.

year the central government's capital expenditure budget included USD 529 m.<sup>48</sup> Even though implementation costs are not insurmountable, spending more to implement WTO obligations will clearly require policy-makers to make sacrifices elsewhere.

That implementation is costly should not be viewed as a reason not to join the WTO. Instead it implies that political leaders must carefully incorporate WTO obligations into their broader economic agenda. Implementation of WTO regulatory rules in Ukraine requires more than a straightforward exercise of drafting WTO-compliant laws; it requires laying the institutional foundations of a market economy.

Suppose you had written a new software program or developed a better mousetrap, which you think consumers are willing to pay for. WTO-compliant laws grant you an intellectual property right over that program or invention. What stands in the way of starting a business to bring that new application to market, or alternatively, selling that right to an investor? How easily can you: Borrow money at prevailing real interest rates? Use existing property as collateral? Establish and register a new business quickly? Write an enforceable contract? Demonstrate that your mousetrap meets international standards? Sell your product in the market? Keep your profits? Creating the institutions that give commercial value to WTO rules is the challenge facing Ukraine.

## References: World Bank Project Documents

The tables in the text draw information from official World Bank project documents. Recent project reports publicly available on the World Bank's project and policies home page (<http://www.worldbank.org/projectsearch/>). Older documents are available from the World Bank archives.

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<sup>48</sup> International Monetary Fund, Government Finance Statistics Yearbook, 2002 (Washington: International Monetary Fund, 2002).



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Memorandum of the President: Poland Agroindustries Development Project, Report No. P-5150-POL (January 5, 1990).

Staff Appraisal Report: Poland Agroindustries Development Project, Report No. 7112-POL (January 3, 1990).

# **12 Effects of WTO Accession on Policy-making in Sovereign States: Preliminary Lessons from the Recent Experience of Transition Countries<sup>49</sup>**

**Marc Bacchetta and Zdenek Drabek<sup>50</sup>**

**World Trade Organization**

## **1 Introduction**

One of the most remarkable successes of the World Trade Organization in recent years has been the expansion of WTO Membership and the continued stream of applications of countries to accede to the WTO. Of the 43 countries that have applied to accede the WTO under Article XII since January 1, 1995, approximately one half are countries in the process of transition from a planned to a market economy. Ten of the 14 countries that have already completed their accession process and between 9 and 13 countries - depending on whether East Asian countries are included or not - of the 28 countries negotiating their accession are transition countries. Clearly, the WTO represents a powerful attraction for countries in transition (CIT) which treat their WTO membership as a "stamp of approval" of their policies and the admission into the international community - a feat quite important for CIT that have been isolated from world markets for more 50 years.

The strong interest of CIT in the WTO Membership raises the obvious question about the benefits to these countries from their accession to the WTO. It is clearly not enough to say that the main benefits are their rights to participate in the proceedings of the WTO Working Committees, Working Parties or the Council.

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What matters at the end of the day are the tangible benefits from Membership. Only if they can point at such benefits will the governments of these countries be able to convince their critics that the decision to join the WTO is right. Only then will they be able to demonstrate to their populations that the government policies are also on the right path.

The purpose of this paper is to discuss one particular aspect of WTO accession - the effects of WTO accession on policy-making and institutional reforms in transition countries. We shall do so by looking at the experience of those transition countries which are already WTO Members. We believe that this will offer a useful picture of the forces that ultimately shape the economic performance of these countries and in particular that it will show how economic performance has been affected by WTO accession. Appendix Table 12.9 shows the dates of application and membership of all CIT. Six of them - the Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia - had signed GATT by 1994. As all other GATT Contracting Parties, they became WTO members upon signing the new WTO agreements. More recently these countries have been joined in the WTO by ten other CIT. These ten new Members which are in the process of transition are, by order of accession, Bulgaria, Mongolia, the Kyrgyz Republic, Latvia, Estonia, Georgia, Albania, Croatia, Lithuania and Moldova.

The advantages of our approach are twofold. First, by drawing on the experience of these countries we hope to shed more light on much debated issues such as the advantages of multilateral as opposed to autonomous trade liberalisation. Second, given that the accession often raises high hopes while in reality it also represents heavy commitments and costly adjustments to new legal and institutional requirements, it is our aim to objectively assess the costs and benefits of accession. The economic transition of the kind undertaken by the former centrally-planned economies is not an easy process and like all other transition countries, the new Members face specific transition related problems.

In order to evaluate the effect of WTO accession on the CIT, we shall adopt the following approach. We shall first ask how much of the trade policy reforms can be attributed to the accession negotiations and how much they reflect autonomous policy initiatives. We shall, therefore, review the policy reforms in the examined countries, identify the autonomous trade measures as well as those that were not covered by the reform. The actual effects of accession on policy-making will then be examined in the following areas: (1) market access, (2) governance, (3) government budget, (4) structural reforms, (5) trade and investment with regional partners, and (6) macroeconomic management. These are areas which we believe are affected by WTO accession most. The CIT have acceded under Article XII of GATT, and we shall consider whether this Article or other rules have constrained domestic policy-making and if so how. The idea is to identify factors that partly offset the positive effect of accession.

Terms of accession are of a major concern to every acceding country. Moreover, there is a perception among some observers that accession conditions may vary among countries and that these conditions may be in excess of measures that incumbents would be willing to take in their own countries.<sup>51</sup> Even though we shall make general comments on accession conditions, we do not intend to discuss this issue in detail. This is quite a major omission. The effects of accession must clearly be dependent, *inter alia*, on the outcome of the negotiations, that is on the conditions which each country is able to negotiate with the WTO Members. We have felt that the issue of accession conditions is so important and, at the same time, complex that it will need to be addressed in a separate paper.<sup>52</sup>

The paper is divided into two parts. The following Part 2 which includes three sections, reviews the role of the WTO and its accession process and looks at the main features of the process. Section 2.1 shortly describes the New Members' accession packages, and Section 2.2 provides an assessment of the scope of autonomous trade policy reforms. The main benefits of joining the WTO are discussed in Section 2.3. The subsequent Part 3 then looks at various aspects of economic policy-making that we have been able to identify and that are affected by WTO accession. The areas have been delineated above and they constitute the subject of the seven sections of Part 3. We shall look at the impact of accession on market access, governance, customs revenues, adjustment costs, regional policies and stabilisation policies. The paper is concluded with a summary of the main findings and some policy conclusions.

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<sup>51</sup> In reporting on discussions in the General Council, Naray noted that "*....a number of developing countries delegations recalled that in the accession process unreasonable conditions were required of, and imposed on, applicants because developed country members had requested that acceding countries accept more stringent conditions and a higher level of commitment than was required from members themselves ('WTO-plus' requirement). For example, the requirement to adhere to several plurilateral agreements, to guarantee full transparency and objectivity and that markets access commitments should be about the same as those made by countries at similar level of development.*" Naray (2001), p.91.

<sup>52</sup> We recognize that the omission of terms of accession makes our discussion incomplete. In addition, by concentrating on specific policy and institutional changes, our approach becomes highly specialized and technical. It should be seen as the first step in the analysis of the subject that we are treating in this paper.

## 2 The WTO accession process

### 2.1 The content of accession packages

Only few WTO rules regulate the process of accession.<sup>53</sup> Accession is governed by Article XII of the Marrakesh Agreement establishing the WTO, which defines in highly general terms the rules for accession to the WTO. The specific terms of accession must be negotiated between the WTO Members and the applicant country. Because each accession is a negotiation between the WTO Members and a particular country with typically different economic conditions, each accession is unique. As Lanoszka (2001) put it: "*Article XII does not stipulate any membership criteria, and this signals perhaps the most problematic legal aspect of the accession process....No guidance is given on the 'terms to be agreed', these being left to the negotiations between the WTO Members and the Candidate. Furthermore, Article XII does not identify any concrete steps nor does it provide any advice when it comes to the procedures to be used for negotiating the terms of accession*".<sup>54</sup> To streamline the examination of accession requests, though, WTO Members have designed administrative procedures some of which are based on unwritten rules. In fact, the best that can be said about the process is that the process is largely governed by unwritten rules derived from precedents and previous rulings.<sup>55</sup>

The main outcome of the accession negotiations are the terms of accession set out in the protocol of accession. The protocol of accession includes all the commitments made by the acceding country on trade and trade-related policies. Those commitments take the form of a general commitment to abide by WTO rules, of a series of specific commitments referred to in the Working Party Report – for instance on transparency in the privatisation process or on price regulations, and of tariff concessions and other commitments as listed in the country's Schedules. The lessons that can be drawn from the examination of the negotiated terms of accession and of the length of the negotiation process mainly concern the accession process itself.

Ideally, acceding countries should accede on terms that are broadly comparable both for acceding countries among themselves and in comparison with incumbents. In practice, however, the situation may evolve somewhat differently. In several areas acceding countries have made commitments in excess of incumbent Members.<sup>56</sup> Acceding countries, for instance, are required to bind all

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<sup>53</sup> For a detailed description of the procedures see, for example, Lanoszka (2001).

<sup>54</sup> Ibid. p. 589.

<sup>55</sup> Ibid. p. 589.

<sup>56</sup> See Langhammer and Lücke (1999), Michalopoulos (2000) or Naray (2001). For further details see also footnote 51.

tariffs while many developing countries still have relatively high shares of their non-agricultural tariff lines unbound. Similarly, there is pressure on new Members to sign all plurilateral agreements. The question whether this practice serves the interests of acceding countries or not is hotly debated. As already mentioned, we will not enter this discussion here except noting the reason why differences such as those noted arise. The reason is that Article XII, which governs the WTO accession process, is limited in scope and lacks precision in terms of setting the specific operational procedures, as we have already noted above. As a result, countries accede to the WTO on "the terms to be agreed by negotiations."<sup>57</sup>

Another unwritten rule concerns the status of acceding countries. A Member's status determines whether it is entitled to use the Special and Differential (S&D) treatment provisions of the WTO agreements. In general, there are no WTO definitions of "developed" and "developing" countries. The general principle is the selection based on the principle of what can be called a "self-appointment". A country can present itself to the WTO as a "developing nation". Other Members, however, may challenge the "request", as it frequently happens in specific subject areas of the WTO Agreements – in particular in the area of intellectual property. For countries joining the WTO through the accession process, their status largely depends, once again, on the terms agreed in each specific area of the accessions negotiations. If there is no explicit mention of the status in the protocol of accession, a new Member can designate itself as a developing country and even though there is very little formal importance to this act. The actual commitments may restrict the scope for S&D treatment provisions. For instance, if an acceding country makes an explicit commitment to restrict its domestic agricultural support at a level that is lower than what is allowed for developing countries, the commitment would be binding even if the country self-appoints itself to the developing country status or if it wanted to increase its agricultural support to the level allowed for "developing countries" at a later stage.<sup>58</sup> In contrast, the rule is quite clear with respect to "least-developed" countries. The WTO recognizes as least developed countries those countries which have been designated as such by

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<sup>57</sup> The choice of the commitments of original Members with similar levels of GDP per capita as a benchmark for assessing the terms of accession was based on the idea of fairness, ie. treating "similar" countries in a similar way. However, accession terms could be also evaluated against other benchmarks such as, for example, the "free trade package". The package is based on the notion that the optimal policy is the one that leads to the elimination of all trade restrictions. Yet another benchmark could be cross-country comparisons in which a country's "package" of accession conditions is compared to that of other country (ies). Clearly, the main problem is to define the optimal package, but the cross-country comparisons remain the most frequently used benchmark in practice. See Michalopoulos (2000) or Langhammer and Lücke (1999).

<sup>58</sup> The "de minimis" level for developing country Members is 10% while it is 5% for developed countries and certain categories of domestic support are exempted from reduced commitments for developing country Members. See Article VI of the Agreement on Agriculture.

the United Nations. There are currently forty nine least developed countries on the UN list, of which thirty are Members of the WTO as of end of 2001 and nine are in the process of accession to the WTO.<sup>59</sup>

The status issue is related to another issue – the right to *transition periods* to implement the WTO Agreements. Article XIV.2 of the WTO Agreement states that a Member which accepts the Marrakesh Agreement after its entry into force shall implement those concessions and obligations in the Multilateral Trade Agreements that are to be implemented over a period of time starting with the entry into force of this Agreement as if it had accepted this Agreement on the date of its entry into force. Transition periods are thus by no means made automatically available to acceding governments. Article XII on the other hand offers Members a margin of manoeuvre. In practice, Members have made it clear that transition periods will only be granted if the applicant is successful in making a strong enough case to prove that such a period is necessary.

Another important, but this time a formal rule concerns the scope of acceding countries commitments. According to Article XII/1, "(T)he accession shall apply to this Agreement and the Multilateral Trade Agreements annexed thereto". In other words, acceding countries are expected to accept all the rules and conditions as specified in each of the WTO Agreements. This rule is known as the *principle of single undertaking*.

It should also be noted that countries are joining the WTO under what may be called *status quo* for the incumbent countries. The acceding countries cannot negotiate any change in the incumbent countries' commitments of market access nor can they negotiate any change in the rules of the WTO Agreements. The acceding country is joining the WTO under the existing commitments of the Members. As any new member of a "club" has to abide by the rules of the club he/she wants to join, countries acceding into the WTO must accept the terms and conditions of the WTO as they stand. This is an unwritten but fully respected "rule" of accession.

## 2.2 Autonomous or Multilateral Trade Liberalisation?

In order to dispel any misunderstanding about the subject of this section, it is important to specify the framework of our discussion from the outset. The purpose of the section is not to discuss the merits or pitfalls of one method of trade

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The nine countries include Bhutan, Cambodia, Cape Verde, Lao People's Democratic Republic, Nepal, Samoa, Sudan, Vanuatu and Yemen. Furthermore, Ethiopia and Sao Tome and Principe are WTO Observers.



liberalisation as opposed to the other.<sup>60</sup> The aim is to discuss the role of WTO accession in the reform process of transition countries. Based on the idea that trade agreements can play the role of external anchors and thereby facilitate trade policy reforms, it may seem that WTO accession has played different roles in different countries. For example, in transition countries that were already WTO Members before the start of their transition, regional integration obviously played the leading role in facilitating the reform process. In other transition countries, WTO accession and regional integration both played a role while in a third group of countries, WTO accession most likely played the most important role. Nevertheless, the WTO disciplines are critical even for countries which may be more reliant on regional agreements since these must typically be WTO consistent. In this section we briefly discuss the relevant experience of four Central European countries - the Czech Republic, Slovakia, Hungary and Poland.

In the four Central European countries - all four GATT Contracting Parties - trade policy reform measures were taken largely autonomously in the first half of the 1990's, that is prior to the conclusion of the Uruguay Round Agreements. Following the collapse of central planning, the countries eliminated foreign trade monopolies and introduced competition into virtually all foreign trade activities. They unified exchange rates and devalued their currencies. Licencing requirements have only been retained for few foreign trade transactions such as trade in arms, drugs, goods of historical or artistic value and other transactions normally permitted in international practices. Price controls have been eliminated on all but a few non-tradeables, export and other trade-related subsidies have been abolished. Eliminated were also all quotas – the pillar of trade policy under central planning.

Thus, the countries were left with tariffs as the only instrument to control the flow of imports. The tariff schedules were all inherited from the previous trade policy regime with a fairly low tariff incidence. For example, the former Czechoslovakia inherited a tariff schedule with about 5% average tariff incidence – clearly one of the lowest in the world. The other two countries – Hungary and Poland - had a tariff incidence somewhat higher but even these two countries demonstrated a fairly open foreign trade regime.<sup>61</sup> Most of their tariffs were bound.

The trend towards trade liberalisation was boosted by RTA negotiations with the European Union. In the early 1990's the countries began their negotiations of the Association Agreements, later relabelled as the Europe Agreements. These were extremely important steps and they affected the course of trade policy in each of these countries. The agreements provided for the establishment of a free-trade area between the EU and each of these four countries but the agreement extends far

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<sup>60</sup> For reasons why countries may be interested in joining international agreements see, for example, Staiger (1995). The reasons for autonomous trade liberalisation have been discussed at length and constitute a major part of economic literature.

<sup>61</sup> For more details, see Drabek and Smith (1995).

beyond a simple free trade arrangement.<sup>62</sup> The agreements led to a radical opening of markets for foreign investment – direct and portfolio – and they covered various other activities such as economic cooperation, customs administration, labour issues, etc. They include provisions covering not only manufactures but also agriculture and services. In addition to the Europe Agreements, these countries have also signed other preferential trade agreements. For example, the Czech Republic has a customs union agreement with Slovakia; it has signed the Central European Free Trade Agreement (CEFTA) with Hungary, Poland, Slovakia, and later with Romania, Slovenia and Bulgaria; it has an agreement with EFTA countries; and it has put in place its own generalized system of preferences. The Czech government has also signed dozens of bilateral agreements on investment protection.

While the speed of liberalisation provided under the umbrella of the Europe Agreements was quite impressive, and so was their scope, the agreements have not gone as far the Uruguay Round Agreements in several areas. For example, in services the Europe Agreements only provided a reference to the ongoing Uruguay Round Agreements binding both the EU and the countries concerned to incorporate into the Europe Agreements the commitments of both parties made in the Uruguay Round. Similarly, the Uruguay Round has gone further than the Europe Agreements in specifying in detail the technical standards as well as sanitary and phytosanitary standards. Excluded were also provisions concerning protection of intellectual property as well as trade-related investment measures such as those covered under TRIPs and TRIMs respectively in the Uruguay Round. Safeguards and anti-dumping measures were also referred to the WTO standards. In brief, the Europe Agreements were the second important stimulus for trade liberalisation – in addition to the governments' own commitments. However, the Agreements have not covered everything – several topics were negotiated under the umbrella of the Uruguay Round.

In sum, the actual Uruguay Round negotiations have brought relatively little in terms of further market opening and trade liberalisation in these transition countries. Most of the liberalisation measures have been taken autonomously and/or as part of various RTAs. As a feature of trade policy-making, the experience of transition countries is not unique; it is a part of a general trend towards "new liberalism" of the 1980s and 1990s.<sup>63</sup> The Uruguay Round Agreements have supplemented the existing reforms in some areas – especially in services, TRIMs, TRIPs as noted, and they have brought disciplines into these

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<sup>62</sup> In the case of Czechoslovakia, the agreements were originally negotiated with the Federal Republic of Czechoslovakia. After the breakup of the federation at the end of 1992, the agreements were negotiated and signed separately with the Czech Republic and Slovakia respectively.

<sup>63</sup> The policy changes are discussed and documented in Drabek and Laird (1998).

countries' trade regimes by adopting multilateral rules on safeguard, anti-dumping and others.

## 2.3 Reasons for joining the WTO

Economists have identified different reasons why countries might be interested in joining an international trade agreement. These can be conveniently fitted into two categories – theoretical arguments and practical considerations. In the first (theoretical) category is the argument stating that governments may be in the position to pursue what is known as "beggar-thy-neighbour" policies and that they will agree to sign international trade agreements as a way of mitigating the incentives to do so. The countries can pursue the "beggar-thy-neighbour" policies by imposing externalities on their trade partners in the absence of an agreement, and the main mechanism through which a country can do so is through changes in terms-of-trade. These changes are, of course, only possible due to the country's large size or its monopolistic position in the market. To put it differently, governments can act in their own interest if they are in the position to impose *optimal tariffs* in order to maximize the country's welfare. However, other (large) countries can do the same, which could lead to trade wars and an erosion of national welfare in each country. By joining a trade agreement, large countries can reach a higher level of national welfare by making their commitments to lower tariffs subject to an international agreement backed by sanctions.<sup>64</sup>

A related theoretical argument concerns strategic interaction between governments and its private sector. As shown in the pioneering work of Kydland and Prescott (1977), the *necessary* condition for economic policy to be *time-consistent* is that governments pursue the first-best policies. This is virtually never the case in the presence of trade interventions. The failure to pursue the best policies will lead to a search for better alternatives and pressures for policy changes. As a result the credibility of government policies to the original commitments will be adversely affected. Once again, an international agreement that locks in the original commitments will boost the government credibility.

On practical level, the attractiveness of WTO has several dimensions. The first attraction of the WTO is that governments are able to obtain an improved access to markets for their exports. The accession itself will not affect the MFN rates of trade partners of the acceding countries. However, the latter will be able to benefit from all commitments made by signatories of the WTO Agreements in future

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<sup>64</sup> Following on the original work of Scitowsky and his own recent work, these issues are reviewed by Staiger (1995). For specific references to transition and vulnerable developing economies, see, for example, Langhammer and Lucke (1999) and Michalopoulos (2000).

trade negotiations.<sup>65</sup> By staying outside the WTO, the countries' trade partners would be in the position to apply discriminatory tariffs against non-members. In addition, non-member countries would have to negotiate border measures with their partners bilaterally or regionally and may be exposed to undue negotiating strength of their partners. The multilateral trading system is, therefore, particularly important for small countries which have a limited power to exploit their (small) size to improve their terms of trade. Their impact on terms of trade maybe enhanced if terms of trade (and, therefore, world prices) are negotiated on a multilateral level.

The second practical reason why countries may be interested in joining the WTO-one that has been already noted above in the theoretical context – is the beneficial effect of the WTO on the *credibility* of government policies. Governments often face a "credibility gap" in trying to convince foreign and domestic investors and the rest of the business community about their commitments to particular policies. By framing the countries' concessions into legal commitments, the WTO Membership provides powerful guarantees of governments' policy directions. Unlike in the case of unilateral policy reforms, policy reforms supported by multilateral commitments are more credible, in particular because of the strategic interaction between the government and the private sector which makes the agreement attractive. In this setting, governments use international trade agreements to enhance the credibility of their policy choices with respect to the private sector. The "credibility gap" is particularly important and present in the case of many if not most transition countries due their history of central planning and political instability.

The third reason is the beneficial effect of the Membership on domestic policies and institutions involved in the conduct of international trade. Acceding countries are required to put in place *a set of norms* and institutions, which support the liberalisation of markets and increase transparency and promote the rule of law, contract enforcement and the evolution of an independent judicial system. In principle, nothing would prevent governments from putting in place these norms and regulations on a unilateral basis. The role of the WTO in this process is to facilitate the introduction of effective reforms not only by reinforcing the credibility of the government's trade policies but also help introduce the policies that are based on best-practices and that must be harmonized.

The fourth reason why the WTO is considered to play an important and positive role is its contribution to the *predictability, security and transparency* of market access. For example, one of the major motivations for the Chinese government to accede to the WTO was the uncertainty to Chinese businesses and the government

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<sup>65</sup> In practice, countries have often benefited from reductions of MFN rates even if they remained outside the GATT/WTO. In such situations the main benefit of joining the WTO would be the certainty and predictability of such benefits, which are by no means guaranteed for outsiders. We are discussing this issue further below.

arising from the temporary nature of tariff provisions applied against Chinese exports in the United States. These provisions have been subject to annual reviews by the US Congress. China's accession to the WTO abolishes this practice, removes the uncertainty and thus reduce transaction costs of doing business and reduce distortions pertaining into investment decisions. Moreover, exports from countries which are considered by their partners as non-market economies are often a main target of anti-dumping measures. Many transition countries could fall into the category of non-market economies. In addition, not only are these measures used frequently but they are usually more restrictive when applied against non-market economies. In sum, the issues of importance are the extension of permanent and unconditional MFN status, and the termination of the designation of transition countries as "non-market economies" by major trading partners such as the US and the EU.

The fifth reason is tied to the WTO's dispute settlement mechanism. The possibility of *resolving disputes* through the dispute settlement mechanism may appear, in particular to smaller and "weaker countries", as one of the most tangible benefits from WTO accession. There are very few effective vehicles to resolve international trading disputes outside commercial arbitration, and those that exist can pity small trading nations against big ones. The WTO dispute settlement mechanism provides a uniquely fair, accessible and effective opportunity to each WTO Member – irrespective of its size and level of income.

Finally, the sixth reason is the opportunity for acceding countries to shape the future rules and disciplines of the WTO. Acceding countries will undoubtedly be interested in participating actively in subsequent multilateral trade negotiations since only through direct negotiations rather than through an oversight from sidelines may they hope of protecting their interests. WTO membership offers them the most direct access to the forum where multilateral trade rules and disciplines are negotiated.

### **3 The WTO and policy-making in sovereign states: stylistic evidence from transition countries**

Accession to the WTO has an important impact on the acceding country. In the rest of this paper, we shall consider how accession affects policy-making and domestic institutions. Accession implies the adoption of WTO disciplines, and this poses a number of challenges for the country concerned. First, accession will affect the access of foreigners into the country's domestic markets, and it is likely to facilitate the country's access to foreign markets. The challenge for the acceding country is to ensure that its industries (i.e. firms producing tradeables) are sufficiently competitive in the face of foreign competition. Second, accession will

impose not only certain disciplines and rules but it will also require the establishment of those institutions and policies that are critical for the enforcement of these disciplines. One area of particular importance is "governance of public and private institutions which will be affected by the WTO accession. Third, accession will also affect government budgets since border measures constitute an element of government policies towards budgetary revenues. Fourth, accession will also lead to various adjustment costs, and these can be divided into two groups - the government (public) financial costs of implementing the WTO disciplines and private costs of market adjustments due to changes in relative prices. Finally, accession will affect the conduct of macroeconomic policy. All these issues will now be discussed in turn.

### **3.1 Market access: limitations of wto commitments**

Arguably the most important and, undoubtedly, most visible effect of the WTO on policy-making concerns border measures affecting the flow of exports and imports. These measures are typically "visible" because they affect market access of acceding countries for their exports and the access of foreign firms to the markets of acceding countries. Thus, the first type of questions that one can ask about the influence of the WTO on policy-making is the following: "How does the WTO affect the extent to which markets of acceding countries have to be opened? Are the acceding countries 'forced' to take unreasonable commitments?" The second type of questions concerns trade policies of other countries and their effect on market access of acceding countries. In particular, are trade policies of incumbent WTO Members affected by the accession of new Members? Is market access of acceding countries improved by the accession? All of these questions are, of course, important for acceding countries because they affect the exposure of these countries to foreign competition and the opening of markets for their exports.

An answer to the first type of questions can be provided with the help of data presented Table 12.1. The table shows for a selected number of countries their bound and applied tariff rates on imports of manufactured and agricultural goods. The distinction between bound and applied tariffs is important because it demonstrates the degree of acceding countries' commitments agreed in the WTO (bound rates) as opposed to the rates actually applied in practice. Bound rate is the critical commitment in the WTO. A bound rate higher than applied rate implies that the country in question is actually pursuing more liberal policies towards imports than it was willing to concede under the terms of accession. Sometimes, of course, countries may not bind their tariff rates in the WTO and agree with Members on a certain level of tariff without binding. This, by definition, gives them a greater flexibility to change tariffs.

What the data in our Table 12.1 suggest is that acceding transition countries have not been exposed in the WTO to unreasonable pressures to open up their markets. Many acceding countries have liberalized their trade regimes unilaterally and have been able to negotiate the terms of their WTO accession within the scope of measures already taken. As a result, their WTO commitments are less "liberal" than the measures actually applied. As can be seen from the table, all countries in our sample actually applied lower tariffs than those bound in the WTO. The only exceptions were the Czech Republic, Hungary and Poland which essentially bound the rates at their actual levels. However, the actual levels were already relatively low, especially in the case of the Czech Republic, and the bindings constituted, therefore, these countries' main concessions on market access. These findings apply both to industrial goods and agriculture. Moreover, some countries were "allowed" to bind their industrial and agricultural tariffs at fairly high levels, as the figures for Bulgaria and Romania indicate. Their bound rates are not only high in absolute terms or relative to other countries but they are also high relative to the corresponding actual rates.

The reply to the second type of questions – how incumbent countries respond to accession of other transition countries – which was brought up in the beginning of this section is relatively simple and straight-forward. As we have noted above, accession to the WTO does not require any change in the existing policies of the incumbent WTO Members. The "rule" also applies to market access conditions for all incumbents including, of course, transition countries. When countries negotiate their WTO accession, incumbent Members make no new concessions on access to their markets. The only changes in their policies may be their commitment to maintain the actual market access conditions on a permanent and thus more predictable basis. *Pari passu*, we have no evidence at present to suggest that any of the incumbent transition countries would have changed their trade or any other policies as a result of accession of another country.

However, an issue that needs to be stated at this point is that the commitments of incumbents are not necessarily granted to the acceding countries automatically. An example of this problem is the recent experience of some transition countries with the provisions of the Jackson-Vanik amendment in the US Congress. WTO membership should in principle automatically confer new Members permanent and unconditional MFN status. In practice, however, this has not always been the case. The MFN treatment extended by the United States to the Kyrgyz Republic was still contingent at the time of writing this paper (2001) on the latter country's adherence to the provisions of the Jackson-Vanik amendment to the 1974 Trade Act regarding freedom of emigration. The US invoked the non-application clause of Article XIII of the Marrakesh Agreement before the accession of the Kyrgyz Republic. Without it, the US would be in violation of their WTO obligation towards the Kyrgyz Republic because of the latter's MFN status being subject to the Jackson-Vanik amendment. The authority for the permanent extension of MFN status to the Kyrgyz Republic has been enacted but not yet implemented.

**Table 12.1**

Bound and applied tariff in selected transition countries

	Simple average bound tariff		Simple average applied tariff	
	Agricultural products	Industrial products	Agricultural products	Industrial products
Albania	10.6	6.0	10.7 (01)	7.0 (01)
Bulgaria	46.7	23.8	27.2 (97)	15.5 (97)
			26.8 (98)	15.3 (98)
			23.6 (99)	12.6 (99)
			23.2 (00)	11.0 (00)
			21.9 (01)	10.0 (01)
Croatia	10.4	5.2	13.8 (01)	5.1 (01)
Czech Republic		4.3		5.6 (96)
				5.3 (97)
				5.0 (98)
				4.5 (00)
Estonia	21.2	7.1	0.0 (96)	0.1 (96)
			0.0 (97)	0.1 (97)
			0.0 (98)	0.0 (98)
			0.0 (99)	0.0 (99)
			13.8 (00)	0.0 (00)
			13.8 (01)	0.0 (01)
Hungary		7.4		8.7 (96)
				8.2 (97)
				7.8 (98)
				7.4 (99)
				7.3 (00)
				7.1 (01)
Latvia	33.3	9.4	16.4 (98)	2.7 (98)
			14.0 (99)	2.6 (99)
Poland		10.4		10.5 (00)
Romania		30.8		17.5 (99)

Note: The figures in brackets refer to dates. The data in the first two columns may not be fully comparable due to different methodologies applied in the computations

Sources: WTO Secretariat, based on Protocols of Accession

Some of the newly acceded countries graduated from the Jackson-Vanik provisions before their accession, while others had to wait some extra time after their accession. The permanent MFN status was extended to the Baltic states in November 1991. Bulgaria graduated from Jackson-Vanik in October 1996, three months before its formal accession to the WTO. But permanent MFN status was



extended to Mongolia only in July 1999, that is more than 2 years after the date of accession.<sup>66</sup>

Perhaps even a better example of the importance of political factors on "market access" of acceding countries is related to the question of "non-market status". In some WTO Member countries, anti-dumping and, in some cases, safeguards procedures applied to the so called "non-market economies" differ from those applied to other countries, as we have noted above. Transition countries acceding to the WTO may have expected that their accession to the WTO would automatically entail their "graduation" from the status of non-market to market economy. However, these expectations turned out to be overly optimistic. In 2000, the Kyrgyz Republic and Mongolia were still on the European Union's list of non-market economies.<sup>67</sup>

### 3.2 Governance and corruption

Beyond its direct impact on efficiency through import liberalisation, the most immediate effect of WTO Membership should be its indirect impact on efficiency through improved governance. Corruption and lack of transparency have large

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<sup>66</sup> The political conditionality may have at least two important implications for acceding countries. First, the absence of guarantees regarding the application of the MFN treatment restricts the benefits of WTO accession to new Members. This element of uncertainty undermines the stability of market access conditions that is conferred by WTO Membership. Given the importance that new Members attribute to the stability and improvement of market access conditions resulting from WTO Membership, the presence of political conditionality reduces the benefits from WTO Membership. Political liberalisation is often linked to the liberalisation of economic policy which, in turn, is likely to lead to the adoption of measures making the economy more competitive, open and less-inward looking. Examples of countries are numerous, including the Russian "Perestroika", the Viet Nameese Doi Moi, the Chinese economic reform, the Czech "Velvet Revolution", and others.

<sup>67</sup> The "non-market status" has been a major cause of trade frictions between many transitions countries on the one hand and the United states and the European Union on the other. It is true that the WTO Agreements do not formally require candidates for accession to have a market economy, even tough the Agreements may be interpreted as implying the condition for firms to operate on strict commercial principles and with prices formed in competitive markets in order to avoid implicit taxation and subsidies. Without full transparency in price policy, the current rules and disciplines of the WTO would be virtually unusable. *e facto*, therefore, the incumbents tend to impose the "market status" requirement on acceding countries. For this reason alone, transition countries have a powerful incentive to introduce such measures that would have them removed from the list of "non-market economies". Some observers argue that the WTO Membership already implies demonstration of policies that are fundamentally market – driven These observers have suggested that the "non-market status" should be terminated upon the countries' accession to the WTO. See, for example, Michalopoulos (2000).

costs for economic development. There is a strong evidence, based on cross country comparisons, that higher levels of corruption are correlated with slower growth and lower levels of per capita income.<sup>68</sup> Corruption is very costly. It undermines well-functioning markets in five ways: as a tax, as a barrier to entry, it leads to a loss of government revenue, it disrupts the operation of markets, and it subverts the legitimacy of the state and its ability to provide institutions that support markets.<sup>69</sup>

Membership in the WTO should help reduce incentives for corruption by providing countries with what are perhaps the most powerful institutional checks and balances in the international economic sphere. Accession imposes changes both in institutions and policies. As discussed above, accession to the WTO provides, once fully implemented, a set of norms which should contribute to the opening of the economy, enhance the transparency of policies, and promote the rule of law and the evolution of an independent judicial system. Theory and evidence suggest that openness reduces corruption.<sup>70</sup> Binding market-access commitments, increased transparency, and market-based institutions should further reduce rent-seeking behaviour and corruption. The adherence to internationally acceptable rules for international trade and FDI imposes stricter disciplines on governments and indirectly on firms.

An assessment of the impact of WTO accession on institutional quality in the acceding countries is difficult and can only be estimated or inferred from business surveys. In addition, many other factors affect the quality of governance. Accession to the WTO is only one of many measures with effect on institutional quality and, most likely, its effect is conditional upon other policies. Moreover, the causality may go in both directions; a high level of institutional quality will facilitate the accession while the accession promotes good institutional quality. Also, it is not, of course, possible to trace the precise time pattern of the effect of accession. It is quite likely, for example, that the institutional quality may be affected long before the actual accession in view of the preparations that the country in question may want to undertake in the anticipation of the actual conditions required by the WTO Membership.

Bearing these limitations in mind, it may be interesting to compare the quality of institutions across countries and over time. By comparing institutional quality indices across countries focusing on the differences between WTO Members and

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<sup>68</sup> See Kaufmann et al. (1999b).

<sup>69</sup> By way of an example, Bulgaria experienced in the second half of the 1990s corruption and problems with border controls. This created severe bottlenecks in international trade, with effects similar to those resulting from protectionist policies. It became evident that a radical customs reform was required in order to improve the border controls. Measures to address corruption have been now incorporated in many projects of the World Bank. For a more general discussion, see World Bank (2001).

<sup>70</sup> See Bonaglia et al. (2001), Broadman and Recanatini (2000) and Treisman (2000).

non-members, we can make a simple test of the effects of WTO Membership. The information is summarized in Table 12.2 reproduced from a recent IMF study (IMF 2000). The table provides two indicators of institutional quality.<sup>71</sup> The first indicator – a "narrow composite index" of institutional quality – is an aggregate of four component indicators: government effectiveness, regulatory burden, rule of law, and graft. The second indicator – a "broad composite index" of institutional quality – is an aggregate of the same four components plus an indicator for the extent of democracy ("Voice and accountability") and one for political instability and violence. The indices, as well as the component indicators, range from –25 (the lowest) to 25 (the highest).

**Table 12.2**  
Indices of institutional quality, 1997-1998

	Government Effectiveness	Regulatory Burden	Rule of Law	Graft	Institutional quality (narrow)	Voice and Accountability	Political Instability and violence	Institutional Quality (broad)
<i>EU accession countries (excluding Baltics)</i>								
Bulgaria	-8.1	5.2	-1.5	-5.6	-2.5	6	4.3	0.1
Czech Republic	5.9	5.7	5.4	3.8	5.2	12	8.1	6.8
Hungary	6.1	8.5	7.1	6.1	7.0	12	12.5	8.7
Poland	6.7	5.6	5.4	4.9	5.7	10.7	8.4	7
Romania	-5.7	2	-0.9	-4.6	-2.3	4.1	0.2	-0.8
Slovak Republic	-0.3	1.7	1.3	0.3	0.8	7.4	6.5	2.8
Slovenia	5.7	5.3	8.3	10.2	7.4	10.7	10.9	8.5
<i>Baltic countries</i>								
Estonia	2.6	7.4	5.1	5.9	5.3	7.9	7.9	6.1
Latvia	0.7	5.1	1.5	-2.6	1.2	6.2	4.6	2.6
Lithuania	1.3	0.9	1.8	0.3	1.1	7.7	3.5	2.6
<i>Other southeastern European countries</i>								
Albania	-6.5	-7	-9.2	-9.9	-8.2	-0.1	-10	-7.1
Bosnia and Herzegovina	-11.1	-12.6	-11.1	-3.5	-9.6	-9.7	-11.6	-9.9
Croatia	1.5	2.4	1.5	-4.6	0.2	-3.2	4.1	0.3
Macedonia, FYR	-5.8	-3.1	-2.6	-5.2	-4.2	0.9	-4	-3.3

<sup>71</sup> All component indicators have been developed by Kaufmann et al. (1999a and 1999b). They are based on 300 separate indicators from two types of sources: ratings produced by commercial risk rating agencies and other organisations, reflecting expert opinions; and surveys of firms and households, compiled by international organisations and other institutions. The aggregates are simple averages.

**Table 12.2 (cont.)**  
Indices of institutional quality, 1997-1998

	Government Effectiveness	Regulatory Burden	Rule of Law	Graft	Institutional quality (narrow)	Voice and Accountability	Political Instability and violence	Institutional Quality (broad)
<i>Commonwealth of Independent States</i>								
Armenia	-6.5	-5.7	-1.5	-8	-5.4	0.2	-4.5	-4.4
Azerbaijan	-8.3	-10	-5.6	-10	-8.5	-9.2	-3.6	-7.8
Belarus	-6.6	-14.7	-8.8	-6.5	-9.2	-5.2	-3.7	-7.6
Georgia	-5.1	-8.5	-4.9	-7.4	-6.5	-2.9	-7.6	-6.1
Kazakhstan	-8.2	-4	-5.9	-8.7	-6.7	-7.1	2.2	-5.3
Kyrgyz Republic	-5.8	-7.6	-4.7	-7.6	-6.4	-2.5	3.2	-4.2
Moldova	-4.6	-2.8	-0.2	-3.9	-2.9	1.6	-2	-2
Mongolia	0.2	1.7	0.4	-1.5	0.2	8.4	3.7	2.2
Russia	-5.9	-3	-7.2	-6.2	-5.6	-3.1	-6.9	-5.4
Tajikistan	-14.2	-15.2	-13.3	-13.2	-14.0	-15.6	-18.6	-15
Turkmenistan	-12.5	-19.3	-9.7	-12.9	-13.6	-14.5	0	-11.5
Ukraine	-8.9	-7.2	-7.1	-8.9	-8.0	-0.1	-2.4	-5.8
Uzbekistan	-13	-14	-8.7	-9.6	-11.3	-13.4	-3.3	-10.4
<i>East Asia</i>								
Cambodia	...	-0.4	-2.3	...	...	-9.1	...	-3.9
China	0.2	-0.7	-0.4	-2.9	-1.0	-13	4.8	-2
Lao People's Dem. Rep.	...	-18.2	-12	...	...	-10.5	...	-13.6
Viet Nam	-3	-4.6	-4.4	-3.3	-3.8	-14.2	6.5	-3.8

Source: based on IMF (2000)

The most striking feature of the data in Table 12.2 is the relatively low value of the institutional index for all transition countries across the board. Clearly, countries in transition (CIT) generally face a major challenge of increasing the quality of their governance. Nevertheless, the table also suggests fairly significant differences. Limiting ourselves to the CITs which acceded to the WTO before 2000 (under Article XII), Estonia, Latvia, and Mongolia have been assessed as countries with a relatively high level of institutional quality. The quality of Estonia's institutions, measured with the narrowly defined index, ranks third among the countries on the track to the EU accession and Mongolia has a higher quality than all CIS countries. The Kyrgyz Republic's institutional quality is among the best compared to other members of the CIS. Bulgaria is lagging behind the other countries on the path to the EU accession with a value of the index that is still above the value of the index for CIS countries. Overall, the table provides some evidence that WTO membership goes hand in hand with higher institutional

quality. Bulgaria did not achieve the same level of institutional quality as the Czech and Slovak Republics, Hungary, Poland or Slovenia, but these countries acceded to the WTO long before Bulgaria.

At a more detailed level, the table reveals the second most striking feature - all of the CITs which acceded the WTO before 2000 except Estonia have corruption as the origin of the low values of the composite indices of institutional quality. Corruption turned out to be the main problem in Bulgaria, Latvia, Mongolia as well as in the Kyrgyz Republic. In the Kyrgyz Republic, however, the index of regulatory burden is as low as the graft index. Since assessments of corruption used by different agencies may be affected by the methodology we have compared two different methodologies which are also reported in Table 12.2. The ranking of countries using different methodologies comes out remarkably similar.<sup>72</sup> This fits into the broader picture that corruption is generally the main problem of governance in all transition countries, and that the ranking of transition countries is not likely to be subject to large random errors.

The positive change emerging from the studies of corruption over time is that the level of corruption may be changing, and that WTO Membership might also have played some role. Three of the five CITs that have acceded to the WTO between 1995 and 2000, saw their corruption indices improve over time even though for two of these countries, the perceived level of corruption has remained a matter of serious concern. As can be seen from Table 12.3, Estonia with its very low tariffs has an impressively low corruption index, and Latvia is not lagging far behind. Mongolia has achieved a lower level of graft than all CIS countries. The "outliers" are Bulgaria and the Kyrgyz Republic. The relatively high corruption level in Bulgaria may be due to the fact that trade liberalisation accompanied a prolonged recession which led to a dramatic reduction in real incomes and hence stronger incentives to enter informal and illegal activities.

The case of the Kyrgyz Republic is interesting. According to Broadman and Recanatini (2000), the implementation of clear and effective regulations and policies must be paired with effective steps to reduce corruption. This conclusion is confirmed by various other studies. The Kyrgyz Republic, for example, is fairly open and its customs tariff is transparent.

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<sup>72</sup> The results are reported in the actual table. They show that the Spearman Rank Coefficient was 0.89.

**Table 12.3**  
Indices of corruption, 1999

	Corruption perception index <sup>1</sup> (1999)	Graft <sup>2</sup> (1999) <sup>3</sup>
<i>EU accession countries (excl. Baltics)</i>		
Bulgaria	3.3	-5.6
Czech Republic	4.6	3.8
Hungary	5.2	6.1
Poland	4.2	4.9
Romania	3.3	-4.6
Slovak Republic	3.7	0.3
Slovenia	6	10.2
<i>Baltic countries</i>		
Estonia	5.7	5.9
Latvia	3.4	-2.6
Lithuania	3.8	0.3
<i>Other southeastern European countries</i>		
Albania	2.3	-9.9
Bosnia and Herzegovina	n.a.	-3.5
Croatia	2.7	-4.6
Macedonia	3.3	-5.2
<i>Commonwealth of Independent States</i>		
Armenia	2.5	-8.0
Azerbaijan	1.7	-10
Belarus	3.4	-6.5
Georgia	2.3	-7.4
Kazakhstan	2.3	-8.7
Kyrgyz Republic	2.2	-7.6
Moldova	2.6	-3.9
Mongolia	n.a.	-1.5
Russia	2.4	-6.2
Tajikistan	n.a.	-13.2
Turkmenistan	n.a.	-12.9
Ukraine	2.6	-8.9
Uzbekistan	1.8	-9.6

<sup>1</sup> Source: Transparency International (1999). The index ranges from 0 (highly corrupted) to 10

<sup>2</sup> Source: Kaufmann et al. (1999a) and (1999b). The index ranges from -25 to 25, with higher values corresponding to lower corruption

<sup>3</sup> 1998 for Mongolia

However, the implementation of the customs tariff has been slowed down by the lack of a functioning administration. As a result, a widespread corruption has developed among customs officials. Supporting evidence is provided by measures

of administrative corruption based on the 1999 Business Environment and Enterprise Performance Survey (BEEPS) taken from Hellman et al. (2000).<sup>73</sup> These authors have unbundled the concept of corruption and distinguished between "administrative corruption", "state capture" and "influence". Administrative corruption is defined as the extent to which firms make illicit and non-transparent private payments to public officials in order to alter the prescribed implementation of administrative regulations placed by the state on the firms' activities. The figures in Table 12.4 show that the level of administrative corruption in Kyrgyzstan is the second highest in the sample of more than 22 transition countries. It is much higher than the overall unweighted average and significantly higher than the CIS average. In general, the message coming from these business surveys is very clear and strong – trade liberalisation and WTO Membership are not sufficient to eradicate corruption – an effective implementation of trade policy measures plays a critical role.

Good governance is also extremely important as an incentive to attract foreign investment. This is especially critical for transition countries and for all other countries that are dependent on foreign investment inflows. WTO membership is seen as an important element of policies aimed at attracting foreign investors by committing Members to apply open, transparent, and stable policies and regulations. As already noted above, WTO accession is only one of many factors that may influence the level of FDI inflows. However, there is now new evidence emerging from the literature that transparency and good governance – supported by WTO Membership - can be instrumental in attracting new foreign direct investment. Evidence provided by the EBRD and others shows that progress in the transition process, which includes effective establishment of market-oriented policies and institutions, together with effective implementation of privatisation, trade linkages, political stability, perceived risk and the predominant type of investment play a key role.<sup>74</sup> A similar message is obtained from a cursory examination of the shares of FDI in GDP in 1995 and 1999 in transition countries presented in Table 12.5.

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<sup>73</sup> The 1999 BEEPS, conducted by the World Bank and EBRD, was designed to assess the quality of governance across 20 countries of Central and Eastern Europe and the Former Soviet Union from a firm level perspective.

<sup>74</sup> The factor "governance including corruption" is only one of the variables affecting the FDI and it is included in the EBRD analyses under the term "progress in transition". See Lankes and Venables (1996) Holland and Pain (1998), and Resmini (2000).

**Table 12.4**  
Measures of administrative corruption<sup>75</sup>

Country	Administrative Corruption	Standard error
Albania	4.0	(0.4)
Bulgaria	2.1	(0.4)
Croatia	1.1	(0.2)
Czech Republic	2.5	(0.4)
Estonia	1.6	(0.2)
Hungary	1.7	(0.3)
Latvia	1.4	(0.3)
Lithuania	2.8	(0.5)
Poland	1.6	(0.2)
Romania	3.2	(0.4)
Slovak Republic	2.5	(0.4)
Slovenia	1.4	(0.3)
Average CEE	2.2	
Armenia	4.6	(0.7)
Azerbaijan	5.7	(0.7)
Belarus	1.3	(0.4)
Georgia	4.3	(0.6)
Kazakhstan	3.1	(0.5)
Kyrgyzstan	5.3	(0.6)
Moldova	4.0	(0.6)
Russia	2.8	(0.2)
Ukraine	4.4	(0.4)
Uzbekistan	4.4	(0.6)
Average CIS	3.7	
Overall (unweighted average)	3.0	

Source: Hellman et al. (2000)

<sup>75</sup> Firms were asked, on average, what percent of revenues do firms like theirs typically pay per annum in unofficial payments to public officials and identify the percentage in the following ranges: 0% - less than 1%; 1 - 1.99%; 2 - 9.99%; 10 - 12%; 13 - 25%; Over 25%. The categories were imputed at M 1%; M 6%; 11%; 19%; 25% and the mean calculated. The question was posed in terms of firm revenues rather than profits since estimates of revenues are more reliable. In addition the question was posed indirectly in terms of "firms like yours" to reassure respondents that their responses would not be attributable directly to their firm. The authors then take total payments as a proxy for administrative corruption since the available evidence suggests that the majority of bribe payments were for this purpose. This measure of administrative corruption differs from the "bribe tax" presented in EBRD (1999), although both were based on the same source. The measure used in Helman's paper includes the responses of all firms, whereas the measure presented in EBRD (1999) presents the average bribes as a share of revenues among firms that reported paying bribes.



**Table 12.5**

Inward FDI stocks in transition countries, 1995-1999 (as a percentage of GDP)

	1995	1999
<i>EU accession countries (excl. Baltics)</i>		
Bulgaria	3.4	19.9
Czech Republic	14.5	33.0
Hungary	22.4	39.9
Poland	6.6	17.2
Romania	3.2	16.1
Slovak Republic	7.3	14.6
Slovenia	9.4	13.0
<i>Baltic countries</i>		
Estonia	18.6	47.9
Latvia	13.8	26.9
Lithuania	5.8	19.7
<i>Other southeastern European countries</i>		
Albania	8.3	16.0
Croatia	2.6	20.2
Macedonia, FYR	1.6	6.1
<i>Commonwealth of Independent States</i>		
Armenia	1.2	23.1
Azerbaijan	14.6	81.4
Belarus	0.3	8.3
Georgia	1.1	7.0
Kazakhstan	14.6	51.9
Kyrgyz Republic	9.7	23.1
Moldova	6.6	28.8
Mongolia	3.9	14.1
Russia	1.6	4.4
Tajikistan	3.9	10.4
Turkmenistan	4.6	31.9
Ukraine	2.5	10.5
Uzbekistan	2.5	6.0
<i>East Asia</i>		
Cambodia	17.0	19.4
China	19.6	30.9
Lao People's Dem. Rep.	11.9	42.8
Viet Nam	31.1	55.6

Source: World Bank, World Investment Report 2000

The fast reformers - which are also the more open countries - have been relatively more successful in attracting FDI than the slow reformers. Among the Baltic countries, Estonia and Latvia have a higher share than Lithuania and when

compared to the non-oil exporting countries in the region, inflows into the Kyrgyz Republic are relatively important. The same conclusion has been reached in more rigorous studies in which the effects of governance and transparency on FDI inflows has been tested in a formal model. Controlling for other economic factors, Drabek and Payne (2002) find a significantly positive statistical relationship between governance and FDI inflows.

### 3.3 Customs revenues

WTO accession may affect customs revenues which is often of an important source of government revenues in countries with relatively low levels of income per capita. This concern is linked to the importance of tariffs as a source of government revenue in many developing countries. But the effect of WTO accession may differ from country to country, and the final outcome is indeterminate *a priori*. To the extent that accession leads to a reduction of tariffs *rates* in the acceding countries, this will tend to reduce tariff revenues. At the same time, however, WTO accession may broaden the tax base. Accession will lead to the elimination of quotas, which are on the WTO list of prohibited trade policy instruments. Quotas are typically replaced by tariffs in the acceding countries, and this switch should add to the governments' capacity to generate revenue. The WTO Agreement on Customs Valuation should also broaden the tax base and thus contribute positively to tariff revenue as customs authorities are more effectively able to register import transactions and collect tariffs. Last but not least, lower tariffs will stimulate in the long run economic activity, and thus the *volume* of imports. This will have a positive impact on tariff revenue as well as on the base of other taxes.

Authorities in many transition countries have also been arguing that WTO accession may be detrimental to their ability to mobilize resources since tariff reductions will result in a severe drop in tariff revenue. Before considering the evidence, it may be useful to make two general comments about the impact of WTO membership on government revenues. The impact of the WTO is likely to be greatly exaggerated for at least two reasons. First, the argument about the adverse impact on government revenues assumes that tariff revenue represents an important source of government revenue. However, most transition countries have acceded the WTO with tariff structures inherited from central planning and these tariffs were relatively low.<sup>76</sup> Second, several transition countries have pursued unilateral trade liberalisation with most of their market opening taking place before their accession to the WTO (e.g. Estonia). Moreover, transition countries

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<sup>76</sup> The reason for the low tariff was their purely administrative character since trade flows were decided by fiat. The example with relatively low tariff include the Czech Republic, Slovakia and to a lesser extent also Hungary and Poland. For more details, see Drabek and Smith (1995).

have tended to bind their tariffs on industrial products at a relatively low level.<sup>77</sup> For all these reasons, there was a relatively less pressure from WTO Members for additional tariff reductions.

**Table 12.6**

Tariff revenues in transition countries, 1991-1999 (in percentage of imports)

	1991	1992	1993	1994	1995	1996	1997	1998	1999
<i>EU accession countries (excluding Baltics)</i>									
Bulgaria	2.2	4.5	7.2	7.6	7.3	4.6	4.8	5.5	2.8
Czech Republic	n.a.	n.a.	3.5	3.5	2.6	2.6	1.7	1.5	1.2
Hungary	9.1	11.8	12.0	12.6	12.9	9.6	4.0	2.6	2.4
Poland	12.7	14.6	15.0	12.0	9.6	7.4	5.6	4.0	3.4
Romania	6.1	4.9	6.6	6.0	4.9	4.2	4.0	5.9	5.5
Slovak Republic	n.a.	2.6	2.3	3.4	3.3	2.9	3.3	2.6	2.7
Slovenia	11.0	6.7	7.3	7.0	7.1	6.2	4.0	2.9	2.6
<i>Baltic countries</i>									
Estonia	n.a.	n.a.	0.9	0.9	0.2	0.0	0.0	0.0	0.0
Latvia	n.a.	n.a.	2.9	3.2	1.8	1.5	1.4	1.1	0.9
Lithuania	n.a.	n.a.	1.1	3.2	1.4	1.2	1.3	1.1	n.a.
<i>Other southeastern European countries</i>									
Albania									
Bosnia & Herzegovina	n.a.	n.a.	n.a.	n.a.	n.a.	10.5	8.6	9.2	n.a.
Croatia	5.4	10.9	7.4	10.7	9.5	8.9	8.0	7.6	8.1
Macedonia, FYR	8.9	6.0	8.5	10.5	12.6	11.4	6.8	7.3	9.1
<i>Commonwealth of Independent States</i>									
Armenia	n.a.	0.2	6.1	0.7	1.0	1.9	2.7	2.8	3.0
Azerbaijan	0.0	0.1	1.4	1.1	1.6	1.9	4.3	4.4	5.4
Belarus	n.a.	n.a.	3.7	5.4	3.2	4.3	3.9	3.8	2.4
Georgia	n.a.	n.a.	n.a.	0.3	0.5	2.0	4.4	4.2	1.7
Kazakhstan	0.0	17.2	0.5	5.6	3.9	2.0	1.5	1.9	1.6
Kyrgyz Republic	n.a.	n.a.	n.a.	1.0	2.3	2.0	2.2	2.4	1.4
Moldova	n.a.	0.8	2.1	1.1	1.4	1.9	2.2	2.0	3.4
Mongolia				7.1	5.1	5.6	2.4	0.4	
Russia	n.a.	3.8	12.0	15.0	11.0	7.8	7.1	7.2	8.9
Tajikistan	n.a.	n.a.	0.9	4.0	1.2	0.6	2.6	6.1	2.1
Turkmenistan	n.a.	n.a.	n.a.	n.a.	0.3	0.3	0.4	0.3	0.5
Ukraine	n.a.	n.a.	n.a.	1.7	1.7	1.2	1.9	2.4	2.3
Uzbekistan	n.a.	1.3	2.4	2.5	2.6	1.6	1.6	1.9	0.7

Source: EBRD (2000)

<sup>77</sup> For more details, see, for example, Drabek and Laird (1998) and Kierzkowski (2000).

Empirical evidence on the evolution of collected tariff rates in transition countries is brought together in Table 12.6. Collected tariff rates are calculated as the share of tariff revenue in the respective country's imports. Figures show that only in a limited number of countries collected rates were relatively high in the first half of the nineties (e.g. Hungary, Poland, Slovenia, Macedonia, Croatia and Russia).

Over time, the number of transition countries in which tariff revenue is an important source of government budgets has considerably dropped. In Hungary, Poland and Slovenia, collected rates fell steadily and dramatically during the nineties. In Macedonia, Croatia and Russia, the trend is less clear as the most recent figures show a rebound. By the end of the decade, however, only the South-Eastern European countries, together with Romania, Azerbaijan and Russia still collected custom revenues at the rates above 5% of imports. Nevertheless, even in these countries the tariff revenue shares are roughly at the level of non-OECD countries.<sup>78</sup> The data thus confirm that the incidence of tariff protection has in general declined in transition countries during the nineties but they also confirm that tariffs do not generally play a major role in transition countries.

This raises the question of how much of the decline was brought about by the accession to the WTO? The answer must be – very little, if at all. In Hungary, Poland and Slovenia, the three countries which experienced the largest reduction of their collected rate, the changes in tariff revenue have primarily reflected autonomous measures and the effects of the Europe Agreements. The latter have tied the trade relations of the Central and East European countries closely with the European Union. The Agreements have established, *inter alia*, free trade areas with tariffs eliminated over a period of 10 years. The case of Bulgaria, which acceded the WTO in 1996, is similar. In Bulgaria, the collected rate fell from its peak at 7.6% in 1994 to 2.8% of total imports in 1999. This reduction is less significant than the reductions in Hungary, Poland, or Slovenia where the rates peaked at respectively 13, 15 and 11% before falling to levels around 2-3%, but it reflects the same influences. In the Baltic countries, the peak was around 3% which does not leave much room for WTO-induced reductions. No clear downward trend can be observed in the South-Eastern European countries up to 1999 but Croatia only acceded by the end of the year 2000. The evolution in the CIS countries is not homogeneous either but, except in one or two cases, the collected rate has remained low during the nineties. The only country which experienced a significant reduction of its collected rate - from 7.1 in 1992 to 0.4% in 1998 – and which might be related to its accession to the WTO is Mongolia. However, given that Mongolia's average bound tariff on industrial products is 18% and that its average bound tariff on agricultural products is even above 19%, the drop in the collected rate is most likely not the consequence of the WTO bindings. Note that in Georgia, the collected rate dropped from 4 to 2 between 1998 and 1999. Given that Georgia acceded in 2000, it is clearly too early to

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<sup>78</sup> Compare, for example, with Ebrill, et al. (2001).

assess the effect of WTO accession but, as with Mongolia, the role of WTO accession can only be limited as the bound rates on industrial products and agriculture were respectively reduced to 6 and 12%.

While the specific reasons for the drop in the collected tariff rate should be investigated and solutions found, we shall confine ourselves to identifying the countries in which a reduction in the collected tariff revenue could potentially pose a serious budgetary problem. As Table 12.6 shows, in some transition countries the share of international trade taxes in total government revenue was not negligible, even if it remained significantly lower than, for example, in African countries where it reaches 30% on average. Mongolia is the country for which the fiscal revenue problem associated with a fall in tariff revenue may be most serious. The figures in Table 12.7 confirm that in Mongolia international trade taxes expressed as a share of total revenue dropped from a relatively high level - more than 11.4% - in 1996 to a relatively low level - less than 1% - in 1998. Similarly, in Georgia where tariffs accounted for about 12% of government revenue in 1997 and 1998.

**Table 12.7**

Share of international trade taxes in total government revenues, %

	1991	1992	1993	1994	1995	1996	1997	1998	1999
<i>EU accession countries (excluding Baltics)</i>									
Bulgaria	2.0	5.2	8.1	7.1	6.7	6.8	6.8	5.5	2.9
Czech Republic			3.9	4.1	3.6	3.7	2.7	2.3	
Hungary	5.0	7.2	7.6	7.6	10.6	9.1	5.0	3.5	
Poland				8.5	7.7	6.5	4.1	3.1	
Romania	3.0	3.6	4.7	4.4	5.6	6.1	5.6		
<i>Baltic countries</i>									
Estonia			1.9	1.8	0.4	0.0	0.0	0.0	0.0
Latvia				4.5	2.7	2.2	2.0	1.6	
Lithuania	0.7		3.7	7.0	3.3	3.0	2.7	2.1	
<i>Other southeastern European countries</i>									
Albania					13.4	17.2	17.8	14.1	
Croatia	3.4	10.7	8.7	9.5	9.2	8.3	8.8	6.7	6.6
<i>Commonwealth of Independent States</i>									
Azerbaijan				50.8	33.4	21.0	8.2	8.9	8.4
Belarus		4.3	17.0	9.7	5.8	5.4	7.6	7.4	
Georgia							11.9	12.1	
Kazakhstan							2.7	3.5	
Kyrgyz Republic				3.0	5.0	5.0	5.0	6.0	4.0
Mongolia		16.7		11.9	8.8	11.4	5.1	0.8	
Russia				14.7	8.7				

Sources: IMF, Government Finance Statistics and Staff Reports

Based on the information at hand, only two other acceding transition countries had a high share of international trade taxes in total government revenue for extended periods of time during the nineties: Azerbaijan, and Albania. In those two countries the fiscal aspect of liberalisation may also be important.

Among the main causes of the decline in collected rates in Mongolia as well as in the other countries are poor customs administration and smuggling. According to press reports, for example, the effectiveness of the border control agencies in Bulgaria was well below par especially during the mid-1990's. Customs revenue collection fell short of targets, and smuggling became widespread. The government authorities were painfully aware of the revenue losses resulting from the poor functioning of its customs administration and invited, therefore, the EU to help Bulgaria improve its customs, as part of its pre-accession assistance. Bulgaria is also currently pursuing a budgetary reform with the creation of a Unified Revenue Agency which will consolidate the collection of taxes and social contributions under a single agency. In Georgia the government has been recently collecting "perhaps 20%, may be even less than 20% of the applicable customs duties, excise taxes and VAT."<sup>79</sup> The same observer noted that "[I] will be surprised if there is any single customs officer on the line who understands, let alone applies the (WTO) customs valuation regulations."<sup>80</sup> The implementation of the WTO's Customs Valuation Agreement may contribute to increased transparency and stability in customs collection.

Two conclusions stand out. First, in most transition countries, tariffs never contributed significantly to government revenue during the last decade. Tariff reductions should, therefore, not cause major budgetary problems. This is not to say that transition countries may not face budgetary constraints but the origin of these problems will most likely not be trade liberalisation. Second, the fall in tariff revenue expressed as a share of imports observed in transition countries who joined the WTO may not be entirely attributable to the lowering of tariff rates following the accession. The tariff reductions are likely to be the consequence of the signing the Europe and similar type of agreements by the Central and East Europeans with the European Union which has led to the creation of free trade areas. In some cases, it may also be the consequence of weak customs administrations, a problem which governments will be well advised to address. An effective implementation of the customs valuation agreement should help countries improve tariff collection and customs administration.

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<sup>79</sup> Quoted from Allen Shinn, Executive Director of IRIS Caucasus Centre; Report on seminar on Georgia's and Kyrgystan's Accession to the WTO, 22 March 2000, Tbilisi, funded under TACIS.

<sup>80</sup> Ibid. pp.28-9.

### 3.4 Implementation costs and budgetary policies

The WTO accession poses another major challenge for acceding countries – they will typically have to carry out fairly significant changes in their policies and institutions to ensure full compatibility of domestic legislation with that of the WTO and the existence of all institutions required for the implementation of the countries' WTO commitments. This raises serious questions for governments of acceding countries. What are the implementation costs resulting from the accessions? While recognizing that the costs may differ among countries, can we identify the main elements of these costs? How high are these costs? Can they be fully and easily absorbed by the acceding country? If the implementation costs are high, should the country pursue its accession objective by taking all or, at least the bulk of the measures before the negotiations or can the measures be introduced during the time of negotiations? Would it be better for the country concerned to plan its accession in such a way that the adjustment costs are minimized? These are important questions for policy-makers and negotiators. We shall not attempt to answer all of these questions which would be beyond the scope of this paper. However, we shall address the first two issues - the main elements of implementation costs and the orders of magnitude of these costs.

Implementation costs are a part of adjustment costs of WTO accession which, in turn, can be divided into two broad categories - public and private costs. The former, in turn, typically includes different types of costs resulting from the implementation of the WTO Agreements, noted above. The first important group includes costs that arise out of *the harmonisation of the country's policy instruments* with those of the WTO. For example, under the GATT and the WTO Article XI, quotas must be replaced by tariff as the sole instrument of trade protection. The economic rationale for this rule is to replace administrative instruments of protection by price-based policy tools. This is a particularly important policy change for transition countries which had traditionally relied on explicit and implicit quotas representing the governments' planning instruments. Thus, replacing the forbidden policy instruments and moving from administrative to market-based instruments will be a radical step. These switches of policy regimes can be complicated, disruptive as well as costly as it is documented on the example of Mongolia and its cashmere industry (Box 12.1). The changes must obviously be handled carefully and only after thorough preparations.

The second important group of adjustment of costs includes the *costs of institutional changes*. The implementation of the WTO agreements is not a simple matter of adopting new laws. For developing and transition countries, it typically involves the setting up of new administrative capacities and substantial changes in technologies and new investment. For example, the Agreement on Sanitary and Phytosanitary Measures, and on Technical Barriers to Trade require the existence of specific testing equipment, legal provisions for SPS and TBT norms, sufficient number of staff with adequate and appropriate skills and so on. The

implementation of Article VII of GATT requires the establishment of administrative capacity, the training of customs officers, the learning of commercial practices, the development of risk analysis and audit systems. The implementation of the TRIPs Agreement is equally investment-intensive and it also requires drafting new legislations, augmenting the administration to review applications, build-up of computerized information systems, extensive training, the setting up of enforcement agencies, etc.

### **Box 12.1**

#### **Mongolia's policy in the cashmere sector**

Since the early 1990s, Mongolia's cashmere sector has been going through important turbulences. World supply of cashmere has increased considerably through the 1990s. Mongolia, whose share of the world market is approximately one third, has contributed significantly to this increase. The breakup of the Soviet-era system left herders free to expand the size of their herds. The size of the flock has increased from 5 million heads in 1989 to more than 11 million in 1998. At the same time, demand for raw cashmere has fallen partly as a result of recession in Japan. The resulting fall in price has been partly offset by sustained purchases of raw cashmere by the government of China, the world's largest producer and exporter.

The Mongolian government has been trying to promote a domestic processing industry. During the last decade, Mongolia's processing capacities have increased significantly, from a handful of processing firms to nearly 30. However, because Chinese processors pay higher prices and, unlike domestic buyers, most often pay in hard cash, herders have increasingly been exporting their raw cashmere to China. Of Mongolia's total yield of 2'700 tons of cashmere in 1998, it is estimated that more than one third went to China. In order to help domestic processors faced with a shortage of raw cashmere, in 1994 the government of Mongolia introduced a ban on exports of raw cashmere which has been in place until 1996. In October 1996, as part of a series of reforms requested by WTO Members as conditions for Mongolia's accession, the government substituted the ban with an export duty at the rate of not more than 30% *ad valorem* to be phased out and eliminated within 10 years of the date of Mongolia's accession to the WTO. GATT Article XI severely restricts the use of export quotas, while export taxes are allowed. It is estimated that of some 1'000 tons that were exported to China, all but 16 tons were smuggled across the border, escaping taxes. The processing industry, which according to specialists is not competitive, complains about the high prices and the shortage of raw cashmere. The herders, whose income had declined by 50% as a result of the ban, continue to be heavily penalized by the export tax and seek the higher prices paid by Chinese processors.

The export tax did not achieve its objective mainly because of implementation problems. But even if it indeed restricted exports, it would still have involved a dead-weight loss and large transfers from the herders to the processors, without helping the herders. Neither the ban nor the export tax were the panacea to the industry's problems. The way out of the present crisis requires a thorough analysis of the industry's problems at each stage. One of such studies revealed, for example, that the main reason for the processors' low competitiveness compared to that of their Chinese competitors is their difficulty to access credits.



These costs may be quite high. In their study of the World Bank and UNCTAD projects in support of the implementation of technical, sanitary, and phytosanitary standards and of the intellectual property law, Finger and Schuler (1998) concluded: *"Implementing (such) reforms are investment decisions in that implementation will require purchase of equipment, training of people, establishment of systems of checks and balances, etc. This will cost money, and the amounts of money are substantial. ... Those figures (of project costs) for just three of the six Uruguay Round Agreements that involve restructuring of domestic regulations, come to USD 130 m. One hundred thirty million dollars is more than the annual development budget for seven of the twelve least developed countries for which we could find a figure for that part of the budget."*<sup>81</sup>

**Table 12.8**

Costs of World Bank projects related to the implementation of three WTO agreements

Area of Implementation	Country	Nature of work	Cost (USD m)
<i>Customs Valuation</i>	10 Eastern European countries	7 yr. Institutional reform – customs modernisation	108
	Tunisia	Customs reform component of a 5 yr. WB export development project	16
	Tanzania	3 yr. reform of customs procedures	8-10
	Lebanon	Customs reform component of a 7 yr. WB fiscal management program	4
	Armenia	4 yr. WB project involving drafting new laws, training staff, computerizing procedures	2
<i>Sanitary and Phytosanitary standards (all WB projects)</i>	Russia	3 yr. SPS implementation – disease control and improvement of food processing facilities	150
	Algeria	2 yr. locust control project	112
	Brazil	7 yr. livestock disease control project	108
	Argentina	5 yr. general agric. export reform project	83
	Poland	5 yr. SPS component of agric. exports development project	71
	Hungary	6 yr. Slaughter-house modernisation project	41
<i>Intellectual Property</i>	Mexico	4 yr. project establishing agency to implement industrial property laws	32.1
<i>Rights (all WB projects)</i>	Indonesia	6 yr. project to improve IPR regulatory framework	15
	Brazil	5 yr. project to train staff administering IPR laws	4

Source: World Bank

The experience of transition countries has been similar – the costs of implementing the institutional reforms appear also quite high. This is documented

<sup>81</sup> See Finger and Schuler (1998), abstract and p. 25.

in Table 12.8 which provides details on costs of the World Bank projects related to the implementation of three agreements – on customs valuation, TBT and SPS.<sup>82</sup>

Even though the costs can be, and in practice they indeed are spread over several years, they still force governments to make difficult choices. Moreover, since these projects are not automatically self-financing (like, say, borrowings against the future stream of income in an industrial project) and they are funded by a foreign currency debt instrument (e.g. IBRD loan), they increase external indebtedness of what may already be vulnerable economies.<sup>83</sup> Full costs of the legal and institutional harmonisation with WTO standards and requirements are much higher.<sup>84</sup> We shall return to these questions further below.

The experience of transition economies in the area of TRIMs is also interesting. Only Romania has notified its use of trade-related investment measures and has requested a delay in the implementation of its TRIMs commitments. In order to provide some empirical evidence with regard to TRIPs, we have reviewed all reports concerning transition countries prepared by the WTO under the TRPM provisions and the degree of success in implementing the TRIPs Agreement. The results are summarized in Box 12.2. As can be seen from the case studies under review, compliance with the TRIPs Agreement has also run into implementation problems in the transition countries. Furthermore, according to the International Intellectual Property Alliance, a private sector coalition formed to represent the US copyright based industries, there is a lack of effective intellectual property rights enforcement in Bulgaria, Estonia and Latvia.<sup>85</sup> Anti-piracy resources are thin and judicial enforcement is almost non-existent. Estonia, for instance, is alleged to have an ineffective copyright enforcement on almost all levels: criminal, civil, administrative and border operations. Enforcement is also hampered because the appropriate officials do not know the proper procedures to take on piracy cases.

The implementation of SPS and TBT Agreements has run into similar problems, and their origins were typically the same - budgetary constraints. For example, a study of implementation of the WTO measures in Bulgaria related to the implementation of the SPS and TBT measures concluded that the main implementation problems lie in the poor financial situation of these countries and

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<sup>82</sup> For more details see *Report on CIS Workshop on WTO Accession*, Moscow, May 17-18, 2000 under the TACIS programme. See also discussion in Section II.5 below.

<sup>83</sup> For more details see the World Bank web-site.

<sup>84</sup> Although not exactly comparable, the costs associated with accession of transition countries to the European Union provide some indications of the size of problem. The Czech authorities estimate that adoption of the EU environmental legislation alone will cost the government CZK 350 bn, or about USD 10 bn.

<sup>85</sup> IIPA 2001 Special 301 Report on Estonia, IIPA 2001 Special 301 Report on Latvia and IIPA 1999 Special 301 Report on Bulgaria.

in the small scale of production. The study distinguished between two types of regulations: those which require substantial changes in the production process and those that do not. The authors conclude that the main problem with the implementation of those agreements which do not require any changes is the shortage of financial resources. The problem with the implementation of the second group of measures is that they require major changes in fixed assets and technologies, and thus – once again - heavy investment.<sup>86</sup> Regulations of the second type are mainly related to the Law on Animal Breeding and regulations issued under the relevant law.

### **Box 12.2**

Implementation of TRIPs agreement in selected transition countries

#### **Hungary**

- Signatory to most multilateral agreements protecting intellectual property.
- Patent and trademark laws have been harmonized with EU legislation.
- Hungary's legislation is now more stringent than the minimum standard laid down by the TRIPs Agreement.
- A substantial unofficial economy persists, making the sale of pirated and counterfeit goods a continuing (though declining) problem.

#### **Poland**

- Signatory to most international agreements protecting intellectual property and member of WIPO.
- However, serious effort required to improve protection of intellectual property to match the EU, especially in the sphere of enforcement.
- Very high piracy rates and a history of lax enforcement led the International Intellectual Property Alliance in 2000 to recommend that Poland be placed on the "priority 301 watch list" by the USTR.

#### **Romania**

- Signatory in recent years to a large number of multilateral conventions on the protection of IPRs.
- Insufficient enforcement at the border remains an outstanding gap in the protection of copyright.

Source: WTO, TPRM Reports for Hungary 1998, Poland 2000 and Romania 1999

In sum, the budgetary implications of the WTO Agreements cannot be underestimated. The financial burden may vary from country to country but the

<sup>86</sup> See Ivanova and Georgieva (2000).

full implementation costs of accession are never negligible. However, the question still has to be asked how these costs compare with benefits which WTO accession is likely to generate for acceding and incumbent countries, an issue to which we shall return in the next section when we discuss another element of adjustment costs – those related to changes in relative prices.

### 3.5 Adjustment costs and policy response

The second, and arguably the most controversial cost of accession are adjustment costs resulting from changes in relative prices and competitive conditions following the accession to the WTO. Liberalisation of the country's trade regime will change the domestic relative prices of goods and services, which, in turn, will lead to increased competitive pressures on industries that had been until now protected by tariffs (or quotas). This, in turn, will create incentives for resources – capital and labour – to move into sectors which are more profitable and efficient. This process of resource re-allocation is not without costs as labour is retrenched and must move and be re-trained (or the opportunity costs of unemployed labour must be imputed into the calculations of adjustment costs). Capital is more mobile than labour but investors will also compute their adjustment costs and take into account, *inter alia*, the sunk costs of capital.

These adjustment costs are principally private costs but they are also likely to have profound implications for economic policy. It would be very rare indeed that the private costs of adjustment would be fully financed by private individuals or firms. More common is for governments to share in financing the costs in order to facilitate the adjustments. The relevant measures include, for example, measures towards labour retraining, unemployment support, etc., all of which force governments to organize their business differently than before.

The experience of transition economies is again illustrative of these adjustment problems. The price liberalisation in the early 1990s led to dramatic changes in relative prices due to deep-rooted price distortions existing under central planning. Privatisation of state assets was typically constrained by severe liquidity shortages. This together with the lack of managerial skills, questionable banking practices, corruption, poor financial supervision, under-capitalisation of banks and bank balance sheets containing a high share of non-performing assets together with other market distortions produced economic results that at best can be judged as highly disruptive. The level of output dropped precipitously and well below the pre-1990 level and remained in many transition countries below that level a decade later. Unemployment reached levels unprecedented in these countries, and all of these countries struggled with dangerous bouts of inflation. It is, therefore, not surprising that many of these countries perceive the market disruptions as the major impediment to trade liberalisation (see Box 12.3). Given the depth of recession, the size of unutilised resources and the collapse of all traditional foreign

trade links, economic theory offers no solution as to the optimal conduct of trade policy under these circumstances.

### **Box 12.3**

#### **Market disruptions in Moldova**

"The government of Moldova has been deeply concerned about the future of its agricultural sector. The agricultural sector has been going through a radical restructuring process. The former collective agricultural enterprises are being transformed into thousands of small private farms with size ranging from between 1 to 3 hectares. The operation of these farms are far from optimal, with "new" farmers lacking a proper understanding of the basic concepts such as enterprise management, efficiency, price policy, product policy, development and new equipment implementation, competition, etc.

The restructuring process of the agricultural sector is being accompanied by a drastic fall in output. Overall agricultural output dropped to Lei 3.01 bn in 1999, which is 55.5% less than in 1993. Due to the loss of subsidies by the former collective agricultural enterprises and the lack of resources of the newly privatised farmers less land is cultivated. The lack of inputs and of investment funds has also forced farmers to switch from high-value to low-value crops, even though in normal market conditions high value crops would be more competitive. The result has been a dramatic and unacceptable fall in rural income."

Source: Statement of Moldovan representative to TACIS-sponsored conference on the WTO accession, Moscow 2000

The response of governments to changes in domestic market conditions critically depend on the impact of these changes on production, employment, price level and welfare. While in the long-run the scope for positive gains from trade is well understood, countries may face adjustment costs in the short-run. We have not been able to collect full information on policy responses of governments in transition countries following or just preceding their WTO accession which would be beyond the scope of this paper.<sup>87</sup> It is clear, however, that the responses will vary. How governments respond in such situations will be determined by a variety of factors such as the depth of disruptions, availability of resources, legal provisions for government interventions (e.g. to provide assistance to ailing industries), etc.

A complicating factor for the assessment of government responses is the negative perception of some governments and observers about the value of WTO Agreements. The Agreements have been subject to two kinds of criticism. The first criticism concerns the effects of welfare and the distribution of benefits from the TRIPs and TRIMs among countries. The argument is that these agreements primarily serve the interests of developed countries and do not bring the corresponding benefits for developing and transition countries. On TRIPs, for

<sup>87</sup> Economic liberalisation has posed a variety of serious allocative problems in transition countries in the wake and following their accession to WTO. For a fuller and more detailed discussion, see Yang (1999).

example, Panagarya (1999) constructed a theoretical case to suggest that the Agreement is a welfare reducing instrument for developing countries as well as for the world as a whole.<sup>88</sup> Similarly, two World Bank economists Finger and Schuler (1998) argued that – in establishing the content of the obligations imposed by the WTO agreements on intellectual property rights (and customs valuation and SPS) – the developed countries have essentially imposed their standards. In their view, the TRIP agreement does not for this reason alone protect indigenous technology nor does it encourage innovation.<sup>89</sup>

The criticism of the TRIMs Agreement is based on the perception that trade-related investment measures are useful as the second-best policy instrument to stem restrictive business practices of multinational enterprises or to offset distortions due to tariffs. The view is rejected by the critics of TRIMs who argue that these measures introduce new distortions which tend to increase the countries' import costs, worsen their balance-of-payments positions, fail to generate export earnings and to transfer modern technology to developing countries. In their view, the specific measures à la TRIMs that target any of the above distortions will be welfare reducing for the country imposing TRIMs. In brief, the critics dismiss TRIMs both on theoretical grounds - pointing to the inefficiencies of these instruments – and on empirical grounds demonstrating their general failure in countries in which were used.<sup>90</sup>

These views sharply contrast with the general assessments of gains to countries from their accession to the WTO. For example, in a recent econometric study based on a nine commodity by twelve regions version of the GTAP model, Yang (1999) estimated the welfare effects of the WTO accession by China, Taiwan and the countries of the former Soviet Union both on the acceding countries themselves as well as on different regions of the world. He found that the accession is likely to bring substantial welfare benefits for the acceding countries and other Asian countries. Welfare gains are found to be much more dubious for other regions and critically depend on the level of agricultural subsidies in the OECD countries. However, if all dynamic factors of globalisation were to be

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<sup>88</sup> For a more comprehensive discussion of the issues see Maskus (1998).

<sup>89</sup> See, for example, Finger and Schuler (1998), p.23. The criticism of TRIPs is, however, much wider and it includes such issues as equitable sharing of benefits arising from the utilisation of genetic resources, transfer of technology, conservation and sustainable use of biological diversity.

<sup>90</sup> The popularity of TRIMs has been quite widely shared among politicians of developing countries even though they no longer attract much interest among economists. The literature on TRIMs and related instruments is vast, and the debate was mainly conducted during the 1970s and 1980s in the context of the related subject – infant industry protection. See, for example, Rodrik (1987). The literature is briefly reviewed in Bora et al. (2000). Examples of more recent economic papers are Morrissey and Rai (1995) and by Balasubramanyam (1991) both of which take a strong pro-TRIMs position.

included in the analysis, which could not be captured by the model itself, the overall welfare gains become even more widespread and evident.<sup>91</sup>

In summary, WTO accession can lead to significant budgetary and other adjustment costs. Even though benefits of accession most likely far outweigh the costs in the long-run, the short-run costs are likely to be high enough to put governments in sensitive situations in which they will be expected to respond in order to ease the burden of implementation of WTO Agreements and the costs of adjustment.

### 3.6 Impact on regional arrangements

Accession to the WTO may sometimes complicate the relations of countries with some of their existing trading partners. Problems have indeed arisen as a result of conflicts between obligations imposed by regional agreements on the one hand and the WTO on the other. Regional trade arrangements may in turn complicate the country's negotiations for accession to the WTO which specifies in Article XXIV of GATT the precise conditions under which preferential trade arrangements are acceptable in the WTO.

Several examples of conflicts between the regional and multilateral integration processes involving transition countries have been documented. As noted above, regional integration projects may affect the country's negotiated terms of accession. The prospect of joining the EU, for instance, provides a strong incentive for a WTO acceding country to adopt a trade policy regime that is less open than that of the EU. The more open a country's trade policy and WTO commitments compared to that of the EU, the higher the compensation that the country concerned will have to pay to third countries upon the country's accession, and the higher the welfare cost of the adoption of the common external tariff to the new EU Member.<sup>92</sup> This is presumably one of the main reasons why Estonia set its applied tariffs at zero but its bound rates are higher because of its prospective accession to the EU.<sup>93</sup> Upon its accession to the EU, Estonia will thus have to replace its current free trade regime by the EU's common foreign trade policy. This will lead to an increase in tariffs and thus to a welfare loss. Estonians expect, however, that these trade diversion costs will be limited because a large share of Estonia's trade is already with the EU. Moreover, the level of EU protection on

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<sup>91</sup> The author recognized that his model excluded, for example, a treatment of better access to market for services, the effects of increased transparency, better protection of intellectual property rights, etc. See Yang (1999), p 526. His findings are broadly consistent with those of other researchers whose work is reviewed in his paper.

<sup>92</sup> In its accession negotiations, Croatia faced conflicting demands from the EU and from other WTO Members on liberalisation of audiovisual services. This was also the case of Latvia, Lithuania, Estonia, Moldova and Bulgaria.

<sup>93</sup> Purju (2000), p.8

raw materials, the main import from non-EU members, is relatively low. Estonia will have to implement the EU's contingent protection measures including its anti-dumping rules but these are WTO consistent. Another example of the conflicts between regional and multilateral commitments is Hungary's resignation from the Cairns group of agricultural exporters. One of the main reasons for this decision was the fear that the membership in the group may be incompatible with EU membership.

Another observation is that regional or bilateral liberalisation may not necessarily spill-over to arrangements with non-preferential trading partners. The signing of Europe Agreements and similar bilateral agreements with other East European countries led to liberalisation of trade and investment between parties without simultaneous alignment of MFN rates of the Central and East European countries. This observation has been made by Kaminski (1999) concerning four other Central European countries. He notes that while in view of the countries' interest to accede to the EU the best tariff policy action would have been an alignment of MFN applied duties on industrial products with the EU post-UR rates, not a single country has chosen to follow this path at the time. Similarly, the Baltic countries have also chosen to wait. Latvia, for example, has made no attempt to "converge" to the EU trade regime in advance of accession despite the fact that Latvia is openly committed to the full adoption of EU trade policy following its accession to the EU.<sup>94</sup> It should be pointed out, however, that all of these transition countries will have to align their MFN rates to the EU as the condition of the accession. The case of Estonia is not representative in the sense that Estonia pursued a more liberal trade policy than the EU's.

The case of the Kyrgyz Republic illustrates how multilateral commitments can create tensions with trading partners, in particular if they are not WTO Members. Most Kyrgyz trading partners are still not members of the WTO. This significantly limits the immediate benefits from accession. On the other hand, its own WTO Membership allows Kyrgyzstan to participate in the Working Parties for the accessions of its trading partners. Kyrgyzstan's WTO commitments were also affected by its regional integration projects. The Kyrgyz Republic had introduced a flat 10% tariff on all products before its accession to the WTO but tariffs were not bound at this level possibly because of the customs union agreement signed with Belarus, Kazakhstan, and Russia in 1996. Following the Kyrgyz accession to the WTO, Russia and Kazakhstan have complained that the Kyrgyz Republic's WTO commitments violated its commitments to its customs union partners - despite the fact that, for the time being, a free trade arrangement rather than a customs union seems to be in place - and would cause a trade deflection, given the weak customs controls between Kazakhstan and the Kyrgyz Republic. Thus, in 1998 and 1999, first Kazakhstan and then Uzbekistan imposed significant impediments to Kyrgyz exports, including very high tariffs, quotas and other trade

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<sup>94</sup> See Muravskaya et al. (2000).



restrictions. In brief, the WTO disciplines do not shield the WTO Members from trade-restrictive measures if they are taken by non-members.

It must be emphasized that regional integration among transition countries does not necessarily conflict with the multilateral trading system. Various studies presented at the recent OECD's roundtable on "Ten years of trade liberalisation in transition economies" provide interesting illustrations of the complementarity of the regional and multilateral trade liberalisation approaches. On the one hand, countries on the accession track to the EU often see the WTO accession as a useful preparation. Purju (2000), for instance, suggests that maybe the most important benefit of the WTO accession for Estonia was the need to respond to the wide range of questions that were raised in the WTO negotiations and that prepared the government and the private sector for the negotiations with the European Union. During the negotiations, Estonia was able to address many issues that are likely to arise in the negotiations with the EU. On the other hand, the harmonisation of rules and policies with the EU is helping the EU-candidate countries to more effectively implement their WTO commitments. For example, Tsvetkovska (2000) believes that Bulgaria's implementation of the WTO disciplines is facilitated by the fact that the economy has to harmonize its national legislation with that of the EU. Along the same line, Muravskaya et al. (2000) point out that the negotiations of the Baltic Free Trade Agreement and of the Europe Agreement have provided an opportunity to acquire experience and expertise in international trade policy-making.

### **3.7 Balance-of-payments management**

In Section 3.4 above, we have already discussed the effect of WTO Membership on countries' internal policies, policy instruments and institutions. Among these effects, perhaps the least familiar but equally important is the effect of the WTO disciplines on macroeconomic policy in the presence of balance-of-payments disequilibrium. To repeat, this issue is perhaps the most understated in the whole debate about the WTO and its impact on the Member countries. The reason for this understatement is partly historical given the perception of the GATT and the WTO as an exclusive domain of trade policy. However, as we shall argue below, trade policy is intermittently tied with domestic macroeconomic and structural policies.

The importance of the broader linkages of trade policy stem from the economic relationship between the current account in balance-of-payments and domestic aggregate variables for savings and investment. This relationship, which is known under the heading of "fundamental identity", links domestic investment expenditures (relative to savings ) to net imports (or net exports). An excess of domestic spending over national savings can only happen if the excess is "funded" through imports and *vice versa*. An excess of national savings over domestic

investment can only happen if the corresponding amount is withdrawn from the domestic economy in the form of net exports.

These linkages have been well understood by the original GATT negotiators. The GATT Articles XII and XVIII make special provisions for countries with balance-of-payments difficulties, and allow these countries to impose import restrictions to ease domestic adjustment and to facilitate the financing of current account deficits. One of the important provisions of these Articles is the temporary nature of the restrictions. The restrictions must not be imposed "permanently" which means that the long-term financing of current account deficits can only be achieved through domestic adjustment which in turn will call for appropriate changes in macroeconomic and structural policies. Another provision specifies that the restriction can only be taken in the form of a uniform import surcharge. Thus, the restrictions must not be selective and subject to different rates of surcharge. In other words, the restrictions must provide uniform protection from imports.<sup>95</sup>

The critical effect of these provisions is to help *introduce a stronger discipline* into domestic policy-making – both on the macroeconomic and structural level. Another reason is to avoid frictions in international trade relations. For example, Members conducting inflationary policies which lead to current account deficits are most likely to run into difficulties with their trading partners if they seek aggressively to depreciate their currencies or restrict imports. While these policies may be seen by the countries that apply them as the first best policy, this is not the case when one takes into account the likely reactions of trade partners. Quite apart from the fact that tariffs are never the first-best policy to correct balance-of-payments disequilibria, both measures can be seen as the "beggar-thy-neighbour" policies. For this reason alone, the policies will be often resisted by the countries that are directly affected by them. The WTO Agreements have nothing to say about the former, but as we have seen above, they are quite explicit about the latter.

Transition countries provide interesting examples of the discipline that has been imposed by the WTO Agreements. During the period of 1995 – 2001 there were seven out of fourteen transition countries – WTO Members that invoked exemptions under Article XVIII of GATT – Bulgaria, the Czech Republic, Hungary, Poland, Slovak Republic, Romania and Yugoslavia (prior to 1995). In other words, the list has covered one half of all transition countries that were WTO Members at the end of the second half of the 1990s. What is particularly important in this respect is the fact that by mid-2001 there was no transition

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<sup>95</sup> Strictly speaking, the uniform rates of import surcharge do not necessarily provide uniform import protection. In theory, this will only happen if production functions are identical in each industry. Otherwise, the governments would have to apply uniform rates of effective tariffs or some other, more sophisticated measures of import restrictions.

country still invoking the exemptions. All of these countries have taken measures to abandon their restrictive trade policies and met their WTO obligations.

The example of the Czech Republic is interesting for another reason – the country's use of a wrong policy instrument. When the Czech government decided to invoke the exemption on the grounds of a rapidly deteriorating balance-of-payments situation in 1996 it chose to restrict imports by requiring importers to make an advance foreign exchange deposit calculated as a percentage of the import bill. The measure was challenged by several trading partners as WTO illegal since the WTO requires that the restrictions can only be made in the form of a uniform import surcharge. The Czech government realized its mistake and shortly, after the notification, it withdrew the import deposit requirement.

The WTO disciplines help strengthen the balance-of-payments management of countries that run into balance-of-payments difficulties. This does not mean, however, that countries eliminate all origins of financial instability. The balance-of-payments difficulties may arise for a variety of reasons including, for example, unstable capital movements, deterioration in terms of trade, loss creditors' confidence, a sharp increase in foreign interest rates and so on. The temporary import restrictions address none of these factors and do not, therefore, eliminate the true origins of the balance-of-payments crisis. What they do provide, however, is the time necessary to take domestic measures to adjust to the changed international environment.

## 4 Conclusions

Five main conclusions come out of our examination of the post-accession experience of the transition countries. *First*, there is no precise blueprint of conditions of accession for new acceding countries. The acceding countries are expected to sign on all WTO Agreements but the detailed conditions of accession may still vary from country to country as a result of negotiations. Thus, the terms and conditions of accession will critically depend on the outcome of the negotiations which, in turn, depend on the negotiating power of the country concerned, negotiating skills, and the country's readiness to agree to and implement the whole range of the WTO disciplines. *Second*, over the last decade most transition countries have made an exceptionally profound effort to liberalize their trade and investment regimes. Accession to the WTO has played an important albeit not exclusive role in this process of liberalisation. The accession has been seen as critical for some countries such as China. In other countries, the autonomous measures taken by these countries have been more important in terms of the degree of liberalisation. *Third*, the costs of the WTO Membership are not negligible. The Membership requires fairly large investment into the modernisation and harmonisation of various institutions directly involved in the

conduct of foreign trade and investment. In addition, WTO commitments also imply for some transition countries significant changes in the conduct of foreign investment policies and in the protection of intellectual property rights. The "switch-over" from central planning to market-based policy instruments may be, therefore, painful but highly valuable as we have tried to document in this paper.

*Fourth*, WTO Membership brings several important benefits to the Members but there are limits how far and how much the Agreements can help. The Agreements can help in terms of a better market access and in terms of the recourse to better policy instruments and institutions. The Agreements cannot address problems originating in poor domestic supply response, terms of trade changes or exogenous shocks. The accession itself may not even open up new markets for the acceding countries because the incumbents are not expected to provide new concessions to them. In addition, the adjustment costs following the WTO accession, - the Membership "fee" - may also be fairly important but they should be more than offset by efficiency gains, growth of trade and inflow of foreign capital. *Fifth*, the WTO experience of transition countries must be seen by and large as positive. The Agreements significantly improve the stability of market access, they help eradicate corruption and improve governance without significant losses to government revenues. Moreover, the WTO has also played a positive role in strengthening domestic policies to better manage balance-of-payments crises.

The difficulties that arise as a result of WTO Membership lead to the logical question whether countries in transition should not receive a special treatment in their quest for WTO Membership. The answer to this question partially depends on the actual terms of accession, and these were not subject of this paper. As a general comment, however, one could say that there is a case to be made for allowing transition countries to fully benefit from the same treatment as countries with similar levels of per capita income. Many of these countries have income capita that would put them right into the category of developing countries, and some would even qualify as least developed countries. This recognition would allow these transition countries to make the required investments as well as the policy and institutional changes over a longer period of time. The case is arguably more evident than the one which would call for a special and differential treatment based on the specifics of these countries as transition economies.

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## Appendix

**Table 12.9**

WTO: dates of accession and membership of transition countries

Application		Membership	Application		Membership
<i>EU accession countries (excluding Baltics)</i>			<i>Commonwealth of Independent States</i>		
Bulgaria	09/1996	12/1996	Armenia	11/1993	
Czech Republic		04/1993 (GATT)	Azerbaijan	07/1997	
Hungary		09/1973 (GATT)	Belarus	09/1993	
Poland		10/1967 (GATT)	Georgia	07/1996	06/2000
Romania		11/1971 (GATT)	Kazakhstan	01/1996	
Slovak Republic		04/1993 (GATT)	Kyrgyz	01/1996	12/1998
Slovenia		10/1994 (GATT)	Moldova	11/1993/	07/2001
<i>Baltic countries</i>			Mongolia	07/1991	01/1997
Estonia	03/1994	11/1999	Russian Federation	06/1993	
Latvia	11/1993	02/1999	Tajikistan	05/2001	
Lithuania	01/1994	05/2001	Turkmenistan		
<i>Other southeastern European countries</i>			Ukraine	11/1993	
Albania	11/1992	09/2000	Uzbekistan	12/1994	
Bosnia and Herzegovina	05/1999		<i>East Asia</i>		
Croatia	09/1993	11/2000	Cambodia	12/1994	
Macedonia, FYR	12/1994		China	07/1986	
Yugoslavia	01/2001		The Lao PDR	07/1997	
			Viet Nam	01/1995	

Source: WTO Secretariat



## **Part III**

# **WTO Membership and Implications for Competition Policy**

# 13 Trade and Competition in the WTO: New Issues for Ukraine

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In this note we discuss the interface between trade policy and competition policy as it affects existing and prospective members of the WTO and trading partners of the EU. Competition policy is taken here to refer to what in the US is called antitrust, i.e. the control of private anti-competitive behaviour and the control of mergers. We argue that it is not a new issue. For the Ukraine this interface is already addressed in its trade agreement with the EU, and it is implicit in certain articles of the WTO that Ukraine will have to respect if it is a WTO member. The paper concludes that the forthcoming trade and competition policy should not pose major problems for a country such as the Ukraine that has already negotiated quite a firm agreement with the EU on these matters.

## 1 Background

The issue of international cartels was high on the agenda of policy-makers after 1945 when the Havana Charter proposed a world wide programme of trade liberalisation and also a global agreement to control restrictive business practices that could distort trade. But the Havana Charter was never signed, and only the GATT (General Agreement on Tariffs and Trade) came into force in 1947. The GATT committed signatories amongst other things to:

- freeze (“bind”) their tariffs at their initial levels;
- periodically negotiate a lowering of these bound levels;
- introduce various other non discrimination provisions into their laws and remove “non tariff barriers”;
- to depart from these basic principles only in special emergencies and according to special procedures (e.g. for anti-dumping and safeguards).

The GATT did not impose any obligations to deal with anti competitive private practices that might frustrate the liberalisation of government initiated barriers to trade. On the other hand the authors of the Rome Treaty in 1957, which created the EEC, did precisely take this into account. They were clearly concerned that private barriers to trade might replace the tariffs and other barriers due to disappear totally by 1969. The Treaty only targeted restrictive business practices that affected trade between member states: it was for member states to deal with their own domestic problems. The key dangers were:

- dominant firms in (say) Germany might be able to erect private barriers to entry to prevent French firms taking advantage of the market opening. This could take a number of possible forms. The dominant firm in Germany might seek to control distribution chains. It might deliberately seek to make targetted prices cuts in the areas where any upstart rival tried to enter. Usually the new entrant would have to cut prices in its new market: the incumbent firm could respond by cutting prices in the entrants home market while not cutting prices in its own, thus signalling that it would prefer to keep prices up, but was ready to fight if it had to;
- firms across Europe could form a cartel to promise they would not compete in each others' markets;
- private firms would set up individual marketing arrangements for their own products that could lead to fragmentation through lack of integration in distribution arrangements.

In addition to this there was a risk that differences in the way competition law was applied in different countries could fragment markets. Not only such obvious matters as discrimination against foreign firms taking over domestic firms, but also differences in what commercial practices might be seen as unfair would make it harder for firms to operate in their neighbours' markets.

But why could it not be left to the national authorities who had after all just signed up an agreement to free up trade? The answer is probably that some member states quite rightly did not trust their partners to be tough enough on their own firms. Thus the argument emerged that Europe needed both a binding agreement that the completely free trade in the Common market should not be frustrated by private business behaviour *and* an agreement that a supranational authority should be set up in the European Commission to ensure this. For the Europeans a supranational agency had the double advantage that no country could cheat by protecting its own firms from competition and also many practices could only be handled at this level; this became more and more true as the Single EU Market came into being.

But other systems prevail in the wider Europe to address this aim. The EU's own competition authorities cannot intervene in other people's markets and so they seek the establishment of equivalent agencies. The Europe Agreements signed by the EU with most of its partners in the CEEC region do provide for the creation of

national competition regimes in the partners, not the creation of a pan-European competition authority (though the agreement with the states of the European Economic Area provides for a supranational but not EU run EFTA Surveillance authority).

As we shall argue below, any negotiations in a WTO context would be about the member states undertaking certain commitments about how they themselves would operate and co-operate, and not about setting up an international agency.

The European experience showed that even when all trade barriers were removed restrictive business practices in the form of cartels and price fixing agreements, abuses of dominant position and restrictive selling practices continued. To pick at random the week this is being written we read that the Commission has fined cartels in the field of building materials and chemicals needed for X ray analysis.

In addition the EU came to understand the importance of regulating mergers from a competition perspective and subjecting the use of intellectual property rights to review by competition authorities

The EU's Community level competition provisions give the Commission authority to policy any private restrictive business practices *that affect trade between member states*. The Rome Treaty did not oblige members to have a competition policy – and where members did have one this affected only their domestic economy. But as the EU integrates the distinctions becomes less.

All recent EU bilateral trade agreements make some reference to the need to control private practices that distort trade. For the original candidate CEEC states, this did not *legally* imply a full domestic competition regime, but this is virtually the only way to implement the obligation to ensure private restrictive practices don't distort trade.

The EU Mexico and the EU South Africa make similar but weaker provisions.

The EU Ukraine agreement also deals with competition. It states:

#### ARTICLE 49

1. The Parties agree to work to remedy or remove through the application of their competition laws or otherwise, restrictions on competition by enterprises or caused by State intervention insofar as they may affect trade between the Community and the Ukraine.

2. In order to attain the objectives mentioned in paragraph 1:

2.1 The Parties shall ensure that they have and enforce laws addressing restrictions on competition by enterprises within their jurisdiction.

Article 49 2.1 in fact seems to go beyond the pure trade dimension. Indeed article 51 says:

## ARTICLE 51

1. The Parties recognise that an important condition for strengthening the economic links between Ukraine and the Community is the approximation of Ukraine's existing and future legislation to that of the Community. Ukraine shall endeavour to ensure that its legislation will be gradually made compatible with that of the Community.

2. The approximation of laws shall extend to the following areas in particular: customs law, company law, banking law, company accounts and taxes, intellectual property, protection of workers at the workplace, financial services, *rules on competition*, public procurement, protection of health and life of humans, animals and plants, the environment, consumer protection, indirect taxation, technical rules and standards, nuclear laws and regulations, transport.

The EU is thus projecting its concept of competition policy on to its trading partners, and its perception of the importance of competition policy to ensure open markets is reflected in its agenda at the WTO.

## 2 The global competition problem

But at the level of the GATT and the WTO the commitments to remove trade barriers have been less than within the EU and as we noted there have been no parallel commitments to deal with abuses of the emerging global market. During the 1980s it was widely felt that market opening resulted only in the good effects of new entry into closed markets and the risks of the creation and abuse of new dominant positions were hardly considered. During the 1990s the perception changed and the need for a global reflection on competition policy was revived.

In fact research carried out in the last 10 years or so indicates that the biggest problem that might be faced by the trading community is not so much that competition laws or their absence operate so as to constitute barriers to trade, but rather that, much as was the case when the EU first opened up, free trade alone is not enough to prevent world wide price fixing and market sharing arrangements. The US has actively prosecuted international cartels abusing its own consumers; in doing so it has revealed the extent of the problem facing the wider world but actions by the US do not exclude abuses continuing elsewhere, in countries that either don't have a competition law or cannot access the information to use it successfully.

Among the industries found to be heavily cartelised have been vitamins, steel, shipping, chemicals, heavy electrical engineering, product which most developing countries have to import from these very same firms.

### 3 Competition policy and the WTO

Although the original GATT and the WTO Treaties do not require members to have any competition policy, competition policy is not absent from the WTO rules.

Most importantly Article III of the GATT (1947 and 1994) requires that all domestic taxes and regulations shall reflect the principle of non discrimination in law and fact and until a legal ruling to the contrary this must be assumed to cover any competition law. So while the GATT itself does not discipline private firms it does impose limits on how far member states of the WTO can go in tolerating private behaviour – with the important proviso that this concerns laws that affect trade in goods. The GATT also requires members to ensure that there is no private market sharing in the name of voluntary export restraints (WTO agreement on Safeguards - Article XIX). State trading is also subject to GATT rules. The TRIPS agreement has special provisions which allow members to use competition law to control abuses of IPRs rather in the way the EU has sought to do. Here there is no WTO obligation, but rather an additional *right* that requires the existence of a competition law. And the rather broad Article XXIII provides that states may not introduce trade restrictions by the back door “non violations” an ill-defined notion that is similar to but not the same as the EU’s “measures of equivalent effect”. This article was used in the Kodak Fuji case involving competition policy in Japan.

The GATS, though less complete in some ways, has specific provisions that require governments to ensure that where they have liberalised part of a sector only, the incumbent cannot leverage monopoly power from closed sectors into open sectors. This is especially developed in telecoms, where there are rules on network access.

Ironically for a non member of the WTO the disciplines may actually be more significant. For an existing member the rather elusive regulatory obligations of the WTO only bite if someone chooses to take you before the Dispute Settlement Body. But for an applicant to the WTO, any existing member may veto your accession if they object to any aspect of your economic policy that they feel may inhibit their exports. Therefore it is quite possible for (say) the EU or anyone else to make a policy of insisting that it will only support accession of new transition economy WTO members who have a properly functioning competition policies, even where there is no such requirement for existing members.

All these issues are of especial importance to prospective WTO members: they are not all spelled out in depth in the treaties: article III does not mention competition policy.

In addition to these issue which are already a matter of WTO rules, new negotiations are foreseen as part of the Doha process.

## 4 The Doha Round

In 1996 the Singapore ministerial meeting agreed to a study group on trade and competition issues, and Doha in 2001 signalled a willingness on the part of nearly all members to proceed with negotiations.

Interest in “trade and competition” came from a number of sources. On the one hand there were consumer groups who became increasingly anxious that the benefits of globalisation might not be fully shared. On the other hand there were trade officials in the EU and the US who were initially worried that their exporters might be unable to sell into certain markets, especially Japan, as a result of private barriers to entry and inadequate competition policy enforcement.

Between the two there were Competition authority officials in the US and the EU who found themselves repeatedly dealing with the same cases and realised the need for some form of co-operation. But some of them were, and some remain, very reluctant to see trade negotiators get involved with competition policy.

So what is being discussed (not yet negotiated) at the WTO?

The issues on the table are essentially of two sorts:

1. What sort of domestic competition rules if any should all members of the WTO have.
2. What sort of framework should exist for international co-operation between members of the WTO.

These are quite distinct issues. For a country such as the Ukraine with a relatively new competitive agency the first point would impose new obligations, but the chances are that Ukraine’s laws would already comply especially in the light of the existing EU agreement. On the other hand the second point would involve quite a new set of obligations and *rights*.

The principle protagonist of an international competition policy agreement at the WTO is the EU and above all its Trade Directorate. This is in line with its internal experience and its trade diplomacy as evidenced by the EU Ukraine agreement and other such agreements.

The US has for many years been sceptical, not because it does not recognise the importance of the issue, but because for it has been able to rely on its own national instruments to police worldwide abuses that affected the USA. The US trade negotiators have recently come round to the view that more formalised rules for international cooperation are desirable though the anti-trust authorities are thought to still have some doubts.

Their doubts are shared in much stronger form by some Asian countries who fear that the interests of western business lobbies might prevail over those of consumers: they see an international agreement on competition policy as a way of

forcing developing countries to adopt competition laws that would favour multinational firms at the expense of local firms.

The EU denies this and is arguing for an agreement at the WTO that would cover the following points:

1. Core principles of Competition Law and Policy
  - a) agreement to have a competition authority endowed with sufficient enforcement powers;
  - b) competition law should be based on the principle of no *de jure* discrimination on grounds of the nationality of firms;
  - c) transparency as regards the legislative framework, including as regards any sectoral exclusions;
  - d) guarantees of due process;
  - e) agreement to treat "hard-core" cartels as a serious breach of competition law.
2. Cooperation modalities – to be voluntary.
3. Specific support for competition institutions in developing countries.

It seems likely that any proposal emerging from negotiations that might follow the current discussion stage would have roughly this shape.

For Ukraine the first part, as we suggested earlier, is unlikely to be seriously problematic, in the sense that the EU is in any case going to provide very strong pressures and incentives to the Ukraine to ensure that its legal system has such a shape. Even though the EU-Ukraine agreement appears to be less detailed than some of the EU texts for the WTO. The Ukraine has in any case no interest in resisting plans to have an operational non-discriminatory rule against cartels. It may not want to copy every fine detail of the EU system, but the core principles laid down here are mostly uncontroversial – if one does indeed have a competition law. The one potentially controversial point concerns the rule against the possibility of discrimination on grounds of nationality. The EU is suggesting that countries might have the right to opt out if they wanted to reserve certain sectors for national firms, e.g. by restricting takeovers.

The EU insists that its competition proposals would not affect the ability of countries to have nationally oriented development policies, which are covered by other WTO rules. Indeed one interpretation of the EU proposals would be to make more specific and even narrow down the discipline that existing WTO rules especially Article III bring to bear on competition policy. The EU is specifically seeking to prevent individual cases being taken to the WTO.

Part 2 of the EU proposals would appear to be in Ukraine's interest, though perhaps only marginally so at present. Ukraine would acquire a formal channel to



request co-operation (in a form to be agreed) with other jurisdictions whose firms might be committing abuses or merely seeking to engage in mergers affecting Ukraine. At the same time Ukraine might find itself receiving requests for information on the operations of its firms in some of its regional neighbours.

And Ukraine would benefit from further multi-lateral as well as bilateral assistance.

## **5 Conclusions**

International competition issues already affect all members of the global trading community including Ukraine. And the international trading rules already impose disciplines on what countries in the WTO can do.

Ukraine is in addition strongly affected by its bilateral relations with the EU. It is unlikely that any additional disciplines created by any WTO agreement would be more binding than those the EU seeks to impose. There would be some advantage in being able to profit from co-operation provisions.

The negotiating issue that Ukraine may want to focus on is whether it wants to seek any exemptions for itself within a proposed competition agreement. From an economic perspective it is unlikely to be very productive to seek to exempt important sectors from the application of competition policy. On the other hand there may be certain political reasons why ownership might be a sensitive matter in some sectors.

# **14 The Problem of Subsidisation of the Industrial Sector through the Energy Sector: Lessons for Ukraine from the Russian and Romanian Case<sup>96</sup>**

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## **1 Introduction**

Subsidising households and industry through the energy sector has been, and still is, a widespread phenomenon in transition countries.<sup>97</sup> The topic has recently gained centre-stage in the political debate, having been raised by the EU in the context of Russia's WTO accession negotiations. Energy prices, and more broadly energy sector reform, have also been on the agenda of EU accession negotiations. Apart from the political dimension, subsidising industry through the energy sector has high economic efficiency costs, especially in countries that are net energy importers. It keeps non-viable enterprises alive that are - or at least at market prices for energy would be - loss making, thus creating negative net value-added for the economy. Moreover, as the example of Romania shows, the survival of non-viable enterprises can cause chains of arrears with large negative economic externalities. Both of this put additional burdens on profitable enterprises, and thus slow down economic development. In addition, when energy prices are unsustainably low, incentives are distorted to invest in overly energy intensive

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<sup>96</sup> The views expressed in this paper are those of the author and do not necessarily reflect those of the OECD or the governments of its member countries. I would like to thank Val Koromzay, Silvana Malle and Joaquim Oliveira-Martins for many helpful discussions and suggestions, and Anne Legendre and Thomas Chalaux for statistical assistance.

<sup>97</sup> See e.g. Ahrend/Oliveira Martin (2003), OECD (2002a, 2002b), Pinto et al. (2000) and Petro et al. (2002).

technologies, leading to sub-optimal investment decisions and wasteful energy over-consumption.

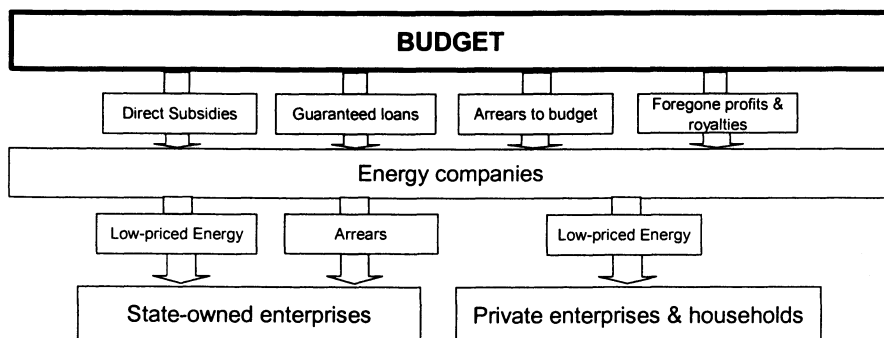
In Ukraine electricity prices for industry are above those charged to households, with the latter being clearly below costs.<sup>98</sup> It is hence often argued that industrial users would cross-subsidise energy consumption of households. Large industrial energy consumers would then be “compensated” for these cross-subsidisation through tax privileges.<sup>99</sup> Due to the non-transparencies it is difficult to make exact calculations. Given the low level of energy prices charged to industry the suspicion is, however, that a more accurate description of the current system may be that Ukrainian households are subsidised directly through the energy sector, whereas part of the industrial sector is subsidised by receiving “compensation” for paying roughly cost covering energy prices.

## 2 The ways of subsidisation are numerous

The exact way of channelling subsidies to industry via the energy sector obviously varies between periods and countries, but the most common methods are depicted in the following Figure 14.1:

**Figure 14.1**

Channels of subsidisation via the energy sector



Energy companies provide enterprises and households with energy at prices below costs. By using non-transparent barter and offset-operations, energy can be provided to industry even below officially set prices. State-owned or politically well connected private enterprises can also be allowed to run up sizeable payment

<sup>98</sup> See e.g. Dodonov et al. (2001).

<sup>99</sup> See Legeida (2001, 2002) for an overview on subsidies to the industrial sector in Ukraine.

arrears to energy suppliers, arrears that are often not meant to be recovered later. In order to provide these subsidies, energy suppliers run down their assets and receive subsidies from the budget in various forms. The latter typically include direct subsidies, state guarantees on loans (that are often ultimately paid back from the budget), the possibility to run up arrears to the budget, and the renouncement of the state to claim profits and royalties from energy companies.

### 3 And the problem is sizeable

When talking about the size of subsidisation one has first to agree on the “right” price of energy, a feature that is particularly difficult for gas and electricity. We take the view that for net energy importers as Romania the import price is the most reasonable choice, whereas for large energy exporters as Russia a production cost based price should be used.<sup>100</sup> For Romania, following our estimates,<sup>101</sup> total subsidies to the economy were around 8% of GDP in 2001, out of which roughly 6% of GDP were channelled via the energy sector, that is through gas, electricity and heating. We further estimate that of this 6%, roughly 2.5% went to households, and the remaining 3.5% went to the enterprise sector, of which half to large state-owned enterprises. To be fair it should be said that Romanian gas and electricity prices were substantially increased in 2002. In spite of leading to an increase in non-payments, the degree of subsidisation should hence have decreased. For Russia, the effective subsidy to the economy from RAO UES, the national energy company, and Gazprom, the national gas company, has been estimated at respectively 4.2 and 2.7% of GDP in 2000. This would add up to a total of roughly 7% of GDP, of which an important part has been going to households.<sup>102</sup>

### 4 The example of Romania

The negative impact that subsidisation of industry via the energy sector has can be clearly seen in the case of Romania. In 2001 many large state owned enterprises (SOE's) were highly loss making. In order to keep on producing, these large loss-making enterprises then “financed” their losses by running up arrears to the budget and state-owned energy suppliers. The following Figure 14.2 shows the strong

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<sup>100</sup> Arguments can also be made in favour of the export price.

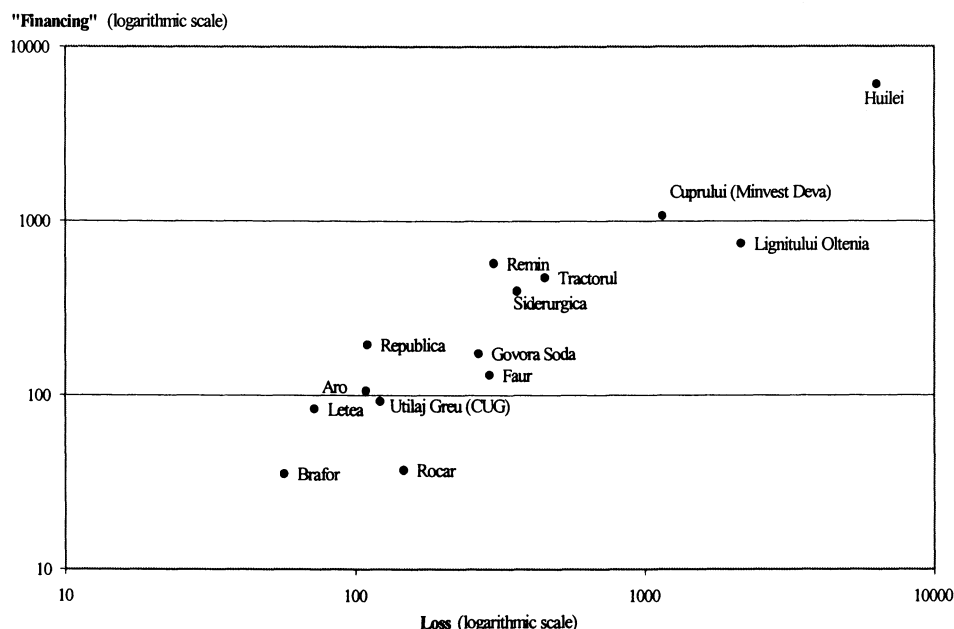
<sup>101</sup> See OECD (2002b) for details.

<sup>102</sup> See OECD (2002a) for details.

correlation between the loss a company was incurring, and the increase in its arrears.

**Figure 14.2**

Romania: how moribound SOE's survive: Losses vs. changes in arrears, 2001, Lei bn



Source: Romanian Ministry of finance; Romanian Ministry of industry and resources; APAPS; INSSE

This "financing" of loss-making SOE's unsurprisingly led to large losses in the energy sector. Energy companies were forced to run down their capital stock, and as they did not have the necessary funds to invest, the infrastructure of the energy sector continued to deteriorate. In 2000, losses of Termoelectrica, the main national electricity production company, were already 44% of turnover. Worse, in 2001 losses still doubled in real terms.<sup>103</sup>

Interestingly, the initial non-payments were concentrated in a small number of companies, but had a strong negative systemic impact as causing large chains of arrears in the economy. Actually, a very large majority of enterprises and households in Romania were paying their bills for electricity, gas, and heating, as witnessed by average collection rates of 80-95%. The problem was a core of large, usually loss making, and almost exclusively state owned enterprises.<sup>104</sup> For

<sup>103</sup> See OECD (2002b) for details.

<sup>104</sup> See Ahrend/Oliveira Martins (2003) for details on this issue.

example, in the beginning of 2002 the twenty largest industrial debtors of Electrica, the electricity distribution company, alone accounted for around 70% of

**Table 14.1**

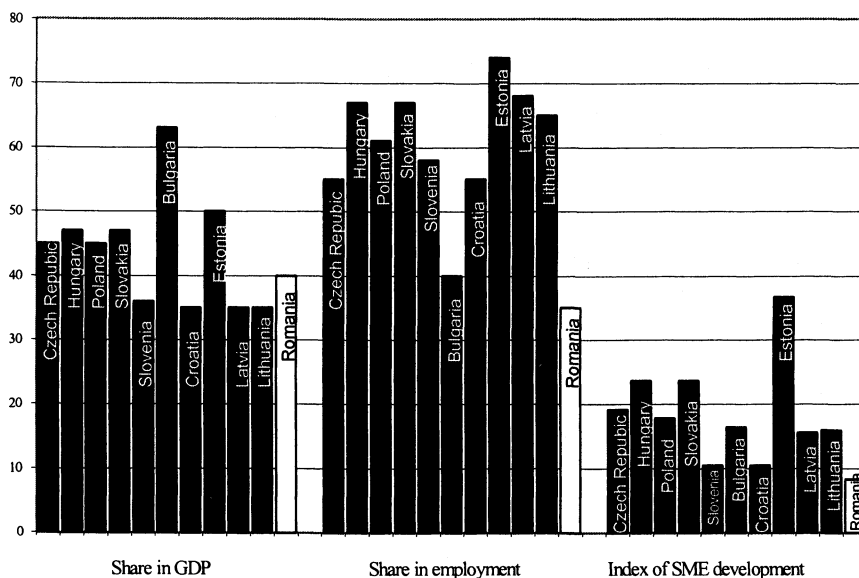
Romania: aggregated arrears of the largest debtors to the energy sector companies, January 2002

	Arrears (bn Lei)	Months overdue
<i>Arrears of heat producing companies</i>		
to Distrigaz Nord	830	3.8
to Distrigaz Sud	2370	9.8
to Termoelectrica	4202	4.7
<i>Arrears of other industrial companies</i>		
to Distrigaz Nord/Sud	2868	7.5
to Electrica	5230	15.1
<i>of which:</i>		
State Controlled	6899	12.8
With State participation	312	16.0
Private	279	10.7
Not identified	609	11.1

Source: Romanian Ministry of Finance

**Figure 14.3**

SME development in Romania compared with other transitions countries, %



Source: UNECE

overdue receivables. Moreover, the thirty largest debtors among the heat production companies and the forty largest industrial debtors accounted for around 80% of overdue receivables of the two gas distribution companies.

The “Survival of the Unfittest” has put a heavy burden on economic development. Subsidisation via (arrears to) the energy sector has allowed moribund enterprises to drag on, and the resulting chains of arrears and a drain of resources has negatively affected the whole economy. As a result the development of the dynamic, that is profitable and job-creating parts of the economy has been slowed down, as shows the comparison of the levels of SME development in Romania with neighbouring countries.

## **5 The problem of subsidisation of industry via the energy sector is difficult to address**

The subsidisation of industry via the energy sector is structurally a very difficult problem. The industrial base in communist countries was build on the assumption of “soviet” energy prices that were significantly below world market prices, and hence with an overly energy intensive technology. Upgrading the technology is costly, if technically feasible and economically viable at all. There are also a couple of political economy considerations that make dealing with the problem even more complex. Certain groups of individuals make sometimes enormous gains in a situation of energy subsidisation. Hence, though the economy as a whole looses, there can be strong vested interest for the continuation of the status quo. This is exacerbated by the fact that, while ending energy subsidisation has large long-term gains for economic development, and hence for employment, short term it may imply loss of employment. In addition, both the subsidisation via the energy sector, as well as its economic costs are often not very transparent, making it politically more difficult to address the issue.

## **6 Conclusions**

While it may be impossible to end subsidising industry via the energy sector instantly, this should be a long term objective, with a clearly defined and stated strategy of how to achieve it. The political viability of such an objective will necessitate changes in the incentive structure so that there is less support for a continuation, and more support for an end of subsidisation. This needs a comprehensive approach including the following measures: Remaining large state

owned enterprises with no public service character should be privatised to limit the interest of the state to keep them afloat via indirect subsidies.<sup>105</sup> Government must be sufficiently strong to resist lobbying pressure from wealthy individuals and firms. Furthermore, energy providers must be empowered to enforce due payments (cut-off policies, bankruptcy procedures), and must be given incentives to do so, that is face hard budget constraints for themselves. To the degree this is possible, competition should be introduced in the energy sector, and the competitive parts should be run by private companies. The non-competitive parts should be regulated by independent regulation authorities - not only *de jure*, but also *de facto* - that have a clear predefined mandate. Ukraine has already undertaken important steps in some areas outlined above, but in most areas further progress still remains necessary.

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<sup>105</sup> As the example of Romania and France show, enterprises will only start to behave like private enterprises once they are fully privatised, this also excluding golden shares.



# 15 Will WTO Membership Really Improve Market Access for Ukrainian Exports?

Igor Eremenko<sup>106</sup>, Nadiya Mankovska<sup>107</sup>, and James W. Dean<sup>108</sup>

## 1 Abstract

Although the WTO embraces over 90% of world trade, several large CIS transition countries have not joined it yet. Delays have not only been due to technical problems, but also to a lack of clear understanding of the consequences of WTO membership. The aim of this paper is to ask how important improved market access might be as an incentive for one of the biggest CIS countries, Ukraine, to join the WTO.

We employ the gravity model of international trade and include data on 85 of Ukraine's trade partners. By looking at initial conditions for Ukrainian exports, we estimate the extent to which Ukrainian exports are hurt by barriers imposed by its trading partners, as well as Ukraine's potential level of trade.

Our estimates show that import barriers imposed by Ukraine's trade partners do not play an important role in determining the volume of Ukrainian exports. Moreover, Ukraine already exports twice the potential level, predicted by our gravity model. Nevertheless, Ukraine depends on small number of unprocessed and semi-processed export goods and the efficiency of its exporting industries is quite low.

These results suggest that the Most Favoured Nation mechanism and putative improved market access might not be an important criteria for deciding Ukraine's accession to the WTO. Our results are consistent with other studies on transition economies, which found that WTO membership plays a much less important role in improving market access than do increasing FDI, regularising dispute settlements, and improving resource allocation.

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<sup>107</sup> Simon Fraser University.

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## 2 Introduction

A high priority of Ukrainian international economic policy is to join the WTO. However, this process has been ongoing for a decade already, and is likely to continue for several more years.<sup>109</sup> This slow progress has been due not only to technical problems, but also to a lack of clear understanding of what consequences WTO membership might entail.

Of course, as any trade policy change, membership in the WTO has its costs and benefits. The main costs are expected to be a short-term decrease of output due to stronger foreign competition, lower fiscal revenues as a result of reduced import tariffs, and restricted sovereignty over trade-related policies. The benefits are believed to include improved access to major export markets via the Most Favoured Nation (MFN) mechanism, access to dispute settlements, invigoration of domestic economic reforms, and an increase of foreign direct investment (Drabek and Laird, 1997). In this paper we concentrate on one of these issues only: improved access to foreign markets.<sup>110</sup>

The conventional view of many Ukrainian economists and policy-makers is that by becoming a member of the WTO, Ukraine will enjoy significant benefits from improved access of domestic exporting enterprises to foreign markets. However, such statements are not backed by any in-depth economic analyses in most cases, and cannot be accepted as self-evident. In fact, several researchers have shown that membership in the WTO does not automatically bring improved foreign market access and increased exports. Moreover, specific features of the Ukrainian economy cast doubt on the prospective increase of exports. Please note that in Ukraine the volume of foreign trade is already extraordinarily high: exports are over 60% of GDP, compared with around 35% in Germany, 30% in Poland or even 45% in oil-exporting Russia. Also, Ukraine still relies on a small number of traditional exports, mostly low- and semi-processed products and in many cases Ukraine still follows the traditional patterns of trade, inherited from the USSR. Since it is not evident to what extent the WTO will help Ukrainian exporters to capture a larger foreign market share, we saw an urgent need for an additional study of this issue.

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<sup>109</sup> The process of Ukraine's accession to the WTO system started in 1993, when the official application was submitted. Since that time 9 Working Party meetings have been held and 10 bilateral agreements with members of the WTO were signed. Although Ukrainian officials claim that it will be possible to become a part of the WTO by 2003, the process will most likely continue for a longer period.

<sup>110</sup> We should note that sometimes access to export markets is understood to include access to the MFN mechanism as well as to dispute settlement. In our study we do not touch upon the second point.

In this study we try to throw some light on this problem by asking two questions: 1) To what extent do barriers imposed by foreign trade partners hurt Ukrainian exports at this moment and 2) What is the potential level of Ukrainian exports? Answering these questions would help us to determine how sensitive Ukrainian exports are to trade barriers - primarily the import tariffs of its partners - and to see whether Ukraine has any scope to increase its exports further. With these results in hands, it will be possible to make some judgements about whether the MFN mechanism would be helpful. We employ a modified gravity model of foreign trade in an attempt to answer these questions.

The paper proceeds as follows: Part 3 reviews the results of other investigations into the effect of the WTO on trade intensity. Part 4 reviews the methodology of the empirical gravity model and presents the results of our model. Part 5 summarizes our findings. The appendix provides detailed tables with model results.

### **3 Does membership in the WTO automatically increase trade?**

One of the prime objectives of the WTO is to smooth trade flows and improve market access by lowering tariffs as well as non-tariff barriers, and by helping with dispute settlements. It is true that since the establishment of the GATT/WTO, international trade has significantly increased. As the WTO report stated (The WTO, 1998), "The achievements of the system are well worth celebrating ... during 50 years of GATT/WTO operations, world trade has increased 16 fold ... merchandise exports grew on average by 6% annually. ... GATT and WTO have helped to create a strong and prosperous trading system contributing to unprecedented growth."

Not everyone shares this optimism, though. Indeed, some recent studies demonstrate that there is no convincing evidence of a strong relationship between membership in the WTO and an increase of exports. Rose (2002 a) provides an econometric study of the effect of the GATT/WTO on trade. For this purpose he uses a gravity model of international trade for 178 trading entities for the period between 1948 and 1999. Rose concludes that "... membership in the GATT/WTO is not associated with enhanced trade, once standard factors have been taken into account. To be more precise, countries, acceding to the GATT/WTO, do not have significantly different trade patterns than non-members. ... we currently do not have strong empirical evidence that the GATT/WTO has systematically played a strong role in encouraging trade." Moreover, Rose (2002 b) shows that there is little evidence that membership in the GATT/WTO has actually liberalised trade policies.

However, others hold to a more balanced point of view. Langhammer and Lucke (2000) studied accession issues for vulnerable economies. They conclude that the benefits springing from WTO membership in terms of improved market access for traditional exports are likely to be limited, given such characteristics as reliance on a small number of export goods (mostly raw materials), weak administrative capacities, large economic vulnerability, lack of market-oriented capacities, and political instability. They point out that supply bottlenecks in accessing countries seem to hamper export expansion more than the policy-induced barriers on the demand side. Instead, Langhammer and Lucke argue that the main gains would come from market-oriented policies and sending positive signals to foreign investors. Jensen, Rutherford, and Tarr (2002) in their work on the WTO and Russia argue that the main trade partners of Russia already employ quite low import tariffs, and thus the MFN mechanism will not bring significant additional benefits. According to their estimates, 70% of the gains in the long term should come from increased foreign investments. Other important factors are improved resource allocation and better dispute settlement mechanisms.

Summing up, we would like to stress that joining the WTO is not likely to bring an automatic increase in external trade as often claimed in Ukraine. The WTO provides acceding countries with good opportunities to develop their foreign trade and promote economic growth. But, it is the responsibility of the countries to themselves to use these opportunities. Whether a new member of the WTO will succeed or fail in this process depends on its political will, on its economic development strategy and on the initial conditions (or scope for growth) of the economy and the external sector specifically. If the initial conditions are not very promising, policy-makers can try to overcome this problem. If they fail, they should be blamed, not the WTO.

Before drawing any conclusions about whether WTO membership will lead to increased exports, it is important to examine initial conditions in Ukraine. Here, we estimated two of them: the cost of trade barriers imposed by foreign partners and the potential level of Ukrainian exports. In the next section we describe the methodology of the gravity model employed for these purpose and discuss the results of our estimates.

## **4 The model and empirical results**

In this section we use the gravity model of international trade for Ukraine. Originally this model was independently developed by Tinbergen (1962) and Poyhonen (1963). Since that time it has been actively used to analyse trade patterns between countries. The basic idea is that trade between two countries will positively depend on the size of their economies, and negatively on transportation costs (usually measured as the distance between countries). Also, trade will be

more intensive between countries with similar levels of income (GDP/capita is usually used as the proxy). The country's land area or its population figure can serve as proxies for its size. Dummy variables, such as a common border or membership in trade organizations are used to capture other influences.

Despite initial doubts by several critics, the gravity model has proved fruitful by throwing light on large variety of research questions. Moreover, recent international trade theory (for example, Deardorf, 1995) has shown that even the simplest gravity model can be derived from major theories of trade, and thus is worth using in empirical studies.<sup>111</sup>

#### 4.1. Cost of trade barriers imposed by foreign partners

In this part of our study aside from the standard variables of the gravity model we add an indicator of trade liberalisation to the estimating equation. This indicator is calculated by the Heritage Foundation for virtually all countries and incorporates three parts: the degree of tariff protection in the country; non-tariff barriers; and corruption in the customs service (O'Driscoll et al. 2002 (a)). The index ranges from "1" (for free) to "5" (for repressed). A higher value of the indicator should have a negative influence on foreign trade.

In this case the specification of our gravity model is as follows:

$$\ln X_{ij} = \alpha_0 + \alpha_1 \ln D_{ij} + \alpha_2 \ln GDP_i + \alpha_3 \ln GDP_j + \alpha_4 Dumm\_CIS_j + \alpha_5 Trade\_Index_j + \gamma$$

where

$X_{ij}$  - exports of the country  $i$  to its trade partner  $j$

$D_{ij}$  - distance between countries  $i$  and  $j$

$GDP_i$  - gross value of the GDP of the country  $i$

$GDP_j$  - gross value of GDP of the trade partner  $j$

$Dumm\_CIS_j$  - dummy for CIS countries

$Trade\_Index_j$  - index of foreign trade policy

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<sup>111</sup> For further discussion of the gravity model and its applications see Anderson (1979), Bergstrand (1985), Davis et al. (1997), Harrigan (2001), Martin (1997), Oguelo et al. (1994), Schumacher (2001), Xymena et al. (2000).

We included data on 85 trade partners for the years 2000 and 2001 and used the pooled cross-section technique. Table 15.1 shows the regression results, estimating the effect of barriers, imposed by trade partners on the Ukrainian export volume.

**Table 15.1**  
Regression results, cost of trade barriers

Variables	<i>ln X UA</i>
Constant	6.332525 (1.497133)
Distance	-1.106063 (-8.812356)***
Gross value of the origins country GDP	0.797468 (0.685728)
Gross value of the trade partner's GDP	0.680858 (10.38499)***
Dummy for CIS	1.796171 (4.824957)***
Index of foreign trade policy	0.474575 (1.785510)*
R-squared	0.51
Total number of observations	170

Note: standard errors are in parentheses; \* - 10% significance level, \*\* - 5% significance level, \*\*\* - 1% significance level

The regression results show that the variables are generally acceptably significant, except for the “constant” and “the gross value of the GDP” variables. The R-squared is quite moderate.

According to estimates, increase of Ukraine’s GDP by 10% would lead to roughly 8% increase of exports, while 10% economic growth in the ROW results in 7% increase of Ukrainian exports. In order to interpret estimate for dummy variable, we have to transform it, taking antilog and subtracting one. Results show that Ukraine would export to CIS countries by 40% more than to other countries.

Surprisingly, the regression suggests that the “Trade Index” variable has the opposite effect on Ukrainian exports from what we would expect: the higher the trade partner’s protection barrier, the more intensive were Ukrainian exports to that country. According to estimates, one point increase in trade index is associated with 47% increase of exports. Such results contradict common sense and accepted theories, and contradict the results of similar studies for other countries. For instance, Wall (1999) uses the gravity model to estimate the cost of protectionism on USA trade. Using the same Heritage Foundation indicator of trade liberalisation in his gravity equation, he finds that this variable has an adverse effect on trade volumes. His model quite specifically shows that trade

barriers by foreign countries reduce US exports by one-fourth, which is equal to almost 2% of US GDP.

Of course, we should not be misled by these results: a positive value of the trade index does not imply that if Ukraine's trade partners would raise the trade barriers even higher, exports would expand further. Instead, a breakdown of Ukrainian trade into regions of export destinations shows that Ukraine has traditionally strong trade links with countries that have high trade barriers. Such links are quite persistent and import tariffs or NTBs, captured by the index of trade barriers has not crucially determined Ukrainian export volumes, at least in the short run.

The primary trade region of Ukraine covers the countries of the former Soviet Union. First of all, Russia alone accounts for more than one-fifth of Ukraine's exports. The CIS as a whole acquires one-third of its exports. Almost all CIS countries have high trade index values, meaning "mostly unfree" or "repressed" trade regimes. Nevertheless, Ukraine intensively trades with these countries, in many cases including special trade arrangements between states, and barter or give-and-take schemes.

Another group of countries, with which Ukraine trades heavily, is the Asian and Middle East region. Several of these countries also have repressed trade regimes, yet Ukraine manages to supply a significant share of its major export item – ferrous metallurgy – to this region.

Also, Ukraine steadily develops new trade relationships with European Union and CEE accessing countries. Currently almost 20% of Ukrainian exports go to the EU and around 15% to CEEC countries. We should note here that the EU has quite low import tariffs, here Ukraine is hurt more by quotas applied primarily to light industry and ferrous metallurgy exports.

Summarising, our modified gravity equation shows that import barriers of trade partners, primarily import tariffs, do not seriously influence the Ukrainian export volume. Despite the generally repressive nature of the trade regimes of many of its partners, Ukraine trades pretty intensively with the rest of the world, reaching a volume of exports over 60% of GDP.

The next question is to ask how this level of exports corresponds to the potential level, predicted by gravity factors. Knowing whether Ukraine under- or over-trades, compared to the predicted volume of exports, we will proceed to further discussion of the issue of improved market access.

## **4.2. Potential level of exports**

In order to estimate trade potentials for Ukraine, we first built a gravity model for the EU countries and then for Central and Eastern European candidate countries. Then, putting actual data for Ukraine into the estimated equations for the EU and

CEEC countries, we can see where Ukraine over- or under-trades compared with these regions and what its potential level of trade is. We decided to compare potential trade with that of the EU and accessing CEE countries because of Ukraine's great interest in integration into Europe.

Thus, we estimated the trade with Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, Portugal, Spain, Sweden and UK (Luxemburg was excluded due to data problems). The CEEC accession countries in our research were represented by Bulgaria, Croatia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia (Cyprus and Malta were excluded as well). As trade partners we included 85 countries from all world regions, using data for the year 2000.

We used the following specification:

$$\ln X_{ij} = \beta_0 + \beta_1 \ln D_{ij} + \beta_2 \ln GDP_i + \beta_3 \ln GDP_j + \beta_4 \ln D GDPpc_{ij} + \beta_5 Dumm\_EU_j + \delta$$

where

$X_{ij}$  - exports of country  $i$  to trade partner  $j$

$D_{ij}$  - distance between countries  $i$  and  $j$

$GDP_i$  - gross value of the GDP of country  $i$

$GDP_j$  - gross value of the GDP of trade partner  $j$

$D GDPpc_{ij}$  - difference in GDP per capita between country  $i$  and trade partner  $j$  (absolute value)

$Dumm\_CIS_j$  - dummy variable. It takes the value "1" if the trade partner belongs to the EU or to group candidate CEE countries, otherwise "0"

Below (Table 15.2) we present the results of the regressions, estimating the gravity model for the EU and CEE countries respectively.



**Table 15.2**  
Regression results, potential level of exports

Variables	<i>ln X EU</i>	<i>ln X CEEC</i>
Constant	1.935932 (0.591668)***	6.374373 (0.521032)***
Distance	-0.514744 (0.060709)***	-1.106980 (0.054971)***
Gross value of origin country GDP	0.974926 (0.034526)***	0.780380 (0.042455)***
Gross value of the trade partner's GDP	0.798021 (0.023883)***	0.593993 (0.030187)***
Difference in GDP per capita	-0.195536 (0.036290)***	0.000968 (0.032726)
Dummy for EU and CEEC	0.652739 (0.113618)***	0.520605 (0.132767)***
R-squared	0.74	0.72
Total number of observations	1175	640

Note: standard errors are in parentheses; \* - 10% significance level, \*\* - 5% significance level, \*\*\* - 1% significance level

As we can see, the model explains the trade patterns of the EU and CEE countries quite well, as confirmed by the value of R-squared. All coefficients have the expected signs and are significant at the 1% level, except for the difference in GDP per capita in the regressions for CEE countries.

In order to estimate the potential level of Ukrainian exports in comparison with the EU and CEE regions, we entered real data for Ukraine to see what volume of goods Ukraine would export, if its trade were explained by the same factors, as apply to the EU and CEE. Estimations of potential Ukrainian exports and their comparison with the actual level are given in Table 15.3 below.

The results show that Ukraine exports 2.19 times more than in the case if its trade was explained by the same gravity factors as for the EU countries and 2.81 times more than in case if factors of the candidate countries of Central and Eastern Europe applied.

**Table 15.3**

Ukraine's actual and potential exports

Trade partners	Ukraine's actual exports (USD m)	Ukraine's exports in comparison with the EU countries' gravity potential		Ukraine's exports in comparison with the CEEC countries' gravity potential	
		Ukraine's potential exports (USD m)	Ratio of actual exports to potential	Ukraine's potential exports (USD m)	Ratio of actual exports to potential
Total (sum of 85 trading partners)	13128	5988	2.19	4677	2.81
Advanced countries	3396	3580	0.95	2636	1.29
CEE countries	2957	602	4.92	855	3.46
CIS countries	4497	684	6.57	756	5.95
Asia	1310	567	2.31	138	9.52
Middle East	684	228	3.01	172	3.97
Africa	96	110	0.87	62	1.54
South America	188	216	0.87	58	3.24

As expected, our estimations suggest that Ukraine significantly over-trades with the former USSR countries: by more than 6 times. Although the share of exports to the CIS gradually decreased over the past several years, economic relations between former Soviet Union countries are still very close and very likely will remain so in the future, especially taking into account plans of Ukraine, Russia, Belorussia and Kazakhstan to establish a Common Economic Area.

Turning to the prospect for improved market access after Ukraine has become a member of the WTO, we should note that not all CIS countries are members of the WTO. Hence, the MFN mechanism will work only in trade with selected CIS economies. We also know that the FSU states already took active steps to optimise trade flows between them, to diminish barriers and ease cooperation. Therefore, WTO accession by Ukraine is not expected to result in a significant increase of exports to the CIS.

The close cooperation between FSU countries runs the danger of locking in trade with technologically outdated economies (Michalopoulos, Tarr, 1997). In this respect relationships with advanced economies could be much more beneficial. As estimations of the model show, Ukraine's actual exports to the EU and other

advanced countries correspond almost one-to-one to the level, predicted by the gravity equations.

In case of the European Union, improved market access is expected to concern primarily ferrous metallurgy (15% of Ukrainian exports to the EU) and light industry (10% of Ukrainian exports to the EU). Currently exports of these goods are restricted by quotas imposed by the EU, but with WTO membership Ukraine would have the chance to reduce these barriers.

Exports to the CEE countries are significantly higher than model predictions (by 5 times in comparison with the EU equation and by 3.5 times in comparison with the CEE equation). High exports can be explained by the traditional links, inherited from SU times, common borders and cultural similarities, such as language, etc.

Ukrainian exports to Asian countries are also above the levels predicted by gravity forces. Here we observe quite large discrepancy between estimations from the EU and CEEC's equations (the ratio of the actual to potential exports is 2.3 in the case of the EU equation and 9.5 in the case of CEEC's). In contrast, the model estimations concerning the Middle East are more or less similar: Ukraine over-trades by more than 3 times. As we reported earlier, the major item of exports to these countries is ferrous metallurgy products.

Finally, exports to Africa and South America are slightly lower than the predictions by the EU, but higher than by the CEEC's gravity equation.

Further development of Ukrainian exports after accession to the WTO and particularly the role of the MFN mechanism will of course depend on import tariffs, agreed on during the bilateral negotiations with the WTO members. In our view, the major impediments to export promotion in Ukraine are those listed by Langhammer et al. (2000) and Jensen et al. (2002). Firstly, they concern the reliance on a small number of export goods with a low degree of processing, and secondly, they are caused by domestic trade barriers, represented by unfavourable administrative and political practices.

The Ukrainian economy depends heavily on exports of ferrous metallurgical products: it is the world's 4<sup>th</sup> largest exporter of steel, 50% of all Ukrainian exports revenues come from metallurgy. Although the volume of steel exports is high, these products are mainly low quality and semi-finished. Moreover, as calculated by Akimova and Scherbakov (2002), the technical efficiency of Ukraine's ferrous metallurgy production is quite low: currently it is at 60% of its potential level.<sup>112</sup> Another important export item - fuel products (10% of exports) -

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<sup>112</sup> Technical efficiency is defined as ability to produce maximum possible output given inputs or, alternatively, minimum possible use of inputs given output. Akimova and Scherbakov (2002) measure relative efficiency of a firm in an industry by comparing

also consists of intermediate products with a low degree of processing. Other export goods are chemical production (10% of Ukrainian exports) and light industry (5% of Ukrainian exports). Unfortunately, the efficiency of these products is low as well: 60% for the chemical production and only 27% for light industry. These results are also supported by Sachs et al. (2000). According to their index of international competitiveness, based on the Global Competitiveness Report, Ukraine is only in the 57<sup>th</sup> place out of the 58 countries on the list. In order to enhance competitiveness of Ukraine's products, decrease of import tariffs by foreign partners is far from being enough. Instead, inflow of foreign investment and know-how should improve the situation.

Putting all these results together, we note that firstly, Ukraine's traditional exports are only minimally influenced by the trade barriers of its partners, as captured by the Heritage Foundation index of foreign trade policy. Secondly, Ukraine already exports twice as much as predicted by gravity forces. Thirdly, Ukraine is over-saturated with exports of intermediary, semi-finished and low-quality goods, while the efficiency of its basic exporting industries is rather low. This gives us grounds to suggest that the MFN regime will not be a significant factor to provide better market access for Ukraine's *traditional* exports.

## 5 Conclusions

The aim of this paper is to question the importance of the factor of improved market access after Ukraine's WTO accession. We looked at the initial conditions of Ukrainian exports from two points of view: an assessment of the potential level of trade for Ukraine, and an examination of the extent to which Ukrainian exports are hurt by barriers imposed by its trade partners. We employed the gravity model of international trade to this end.

Our analysis shows that according to our estimates, import tariffs and NTBs, imposed by Ukraine's trade partners do not play an important role in determining the volume of Ukrainian exports. Ukraine trades more with countries that in general have more restrictive trade policies. Besides that, Ukraine already exports at twice its potential level, when compared with EU and CEEC countries. And finally, Ukraine's exports depend on a small number of goods with a low degree of processing, and the efficiency of the exporting industries is quite low. All this suggests that the Most Favoured Nation mechanism and improved market access might not be important aspects of Ukraine's membership in WTO.

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its output to the output, which can be produced by the most efficient firm, given the same bundle of inputs.

This hypothesis coincides with the results of other studies on WTO and transition economy issues, which also conclude that improved market access plays a much less important role than increased FDI, better dispute settlement mechanisms and improved resource allocation. We think that it is very important to have realistic expectations of the WTO membership consequences. In our minds, Ukrainian policy-makers should not overemphasize the role of improved market access but rather use the opportunity to turn the WTO requirements into market reforms, which will send positive signals to foreign investors, will help to advance technology and improve productivity.

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## Appendix

### A.1 Data

The data on exports is for 2000, in million USD. Taken from IMF, Directions of Trade Statistics, March, 2002.

The GNI per capita is for 2000, USD/capita. Available from World Bank, World Development Indicators 2002.

The Gross GNI is for 2000, in billion USD. Available from World Bank, World Development Indicators 2002.

The distance between countries used is the “as-the-crow-flies” distance between their capitals in km. The distance calculation uses the “geod” program, which is part of the ‘PROJ’ system of the US Geological Survey. Available from [www.indo.com/distance](http://www.indo.com/distance).

### A.2 Regression results

**Table 15.4**

Cost of trade barriers

Dependent Variable: LOG(X\_UA?)

Method: Pooled Least Squares

Sample: 2000 2001

Total panel observations 170

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	6.332525	4.229767	1.497133	0.1363
LOG(DIST?)	-1.106063	0.125513	-8.812356	0.0000
LOG(GDP_UA?)	0.797468	1.162951	0.685728	0.4939
LOG(GDP?)	0.680858	0.065562	10.38499	0.0000
LOG(INDEX?)	0.474575	0.265793	1.785510	0.0760
DUM CIS?	1.796171	0.372267	4.824957	0.0000
R-squared	0.511337	Mean dependent var		3.750091
Adjusted R-squared	0.496438	S.D. dependent var		1.993449
S.E. of regression	1.414593	Sum squared resid		328.1759
F-statistic	34.32188	Durbin-Watson stat		0.103535
Prob(F-statistic)	0.000000			



**Table 15.5**

Gravity model for the EU

Dependent Variable: LOG(X?)

Method: Pooled Least Squares

Included observations: 88

Total panel observations 1175

White Heteroskedasticity-Consistent Standard Errors &amp; Covariance

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	1.935932	0.591668	3.271990	0.0011
LOG(D_GDPPC?)	-0.195536	0.036290	-5.388109	0.0000
LOG(D?)	-0.514744	0.060709	-8.478799	0.0000
DUMM_EU_CEEC	0.652739	0.113618	5.745035	0.0000
LOG(GDP?)	0.974926	0.034526	28.23714	0.0000
LOG(GDP_GROSS)	0.798021	0.023883	33.41340	0.0000
R-squared	0.739155	Mean dependent var		5.204044
Adjusted R-squared	0.738039	S.D. dependent var		2.374407
S.E. of regression	1.215272	Sum squared resid		1726.479
Log likelihood	-715.2675	F-statistic		662.5170
Durbin-Watson stat	1.548102	Prob(F-statistic)		0.000000

**Table 15.6**

Gravity model for the CEEC

Dependent Variable: LOG(X?)

Method: Pooled Least Squares

Included observations: 84

Total panel observations 640

White Heteroskedasticity-Consistent Standard Errors &amp; Covariance

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	6.374373	0.521032	12.23413	0.0000
LOG(D_GDPPC?)	0.000968	0.032726	0.029585	0.9764
LOG(D?)	-1.106980	0.054971	-20.13757	0.0000
DUMM	0.520605	0.132767	3.921202	0.0001
LOG(GDP?)	0.780380	0.042455	18.38138	0.0000
LOG(GDP_GROSS)	0.593993	0.030187	19.67691	0.0000
R-squared	0.722489	Mean dependent var		3.164401
Adjusted R-squared	0.720300	S.D. dependent var		2.076813
S.E. of regression	1.098357	Sum squared resid		764.8503
Log likelihood	-524.2681	F-statistic		330.1182
Durbin-Watson stat	1.852042	Prob(F-statistic)		0.000000

### A.3 Ukraine's actual and potential exports to different groups of countries

**Table 15.7**

Ukraine's actual and potential exports. European and other advanced countries

Trade partner	Ukraine's actual exports	Ukraine's exports in comparison with EU countries		Ukraine's exports in comparison with CEEC countries	
		Ukraine's potential exports	Ratio of actual exports to potential	Ukraine's potential exports	Ratio of actual exports to potential
Total	3396	3580	0.95	2636	1.29
United States	727	427	1.70	105.6	6.89
Canada	59	57	1.03	23.3	2.53
Australia	12	26	0.46	7.7	1.56
Japan	68	226	0.30	64.1	1.06
New Zealand	1	5	0.19	2.0	0.51
Austria	164	113	1.45	166.4	0.99
Belgium	107	101	1.06	101.8	1.05
Denmark	25	83	0.30	115.9	0.22
Finland	24	76	0.32	117.7	0.20
France	114	387	0.29	257.4	0.44
Germany	741	669	1.11	565.6	1.31
Greece	48	75	0.64	85.5	0.56
Ireland	27	37	0.73	38.0	0.71
Italy	644	374	1.72	280.8	2.29
Netherlands	138	147	0.94	138.1	1.00
Norway	18	68	0.26	87.3	0.21
Portugal	20	32	0.62	15.6	1.28
Spain	163	176	0.92	103.9	1.57
Sweden	8	64	0.13	41.6	0.19
Switzerland	150	55	2.75	72.2	2.08
United Kingdom	138	381	0.36	245.2	0.56

**Table15.8**

Ukraine's actual and potential exports. CEEC countries

Trade partner	Ukraine's actual exports	Ukraine's exports in comparison with EU countries		Ukraine's exports in comparison with CEEC countries	
		Ukraine's potential exports	Ratio of actual exports to potential	Ukraine's potential exports	Ratio of actual exports to potential
Total	2957	602	4.92	855	3.46
Albania	4	5	0.82	7.3	0.55
Bulgaria	383	24	16.02	32.6	11.74
Croatia	15	37	0.41	48.6	0.31
Czech Republic	189	52	3.62	69.2	2.73
Estonia	55	9	6.28	18.1	3.04
Hungary	327	55	5.97	84.3	3.88
Latvia	167	14	12.18	29.0	5.77
Lithuania	83	24	3.53	56.2	1.48
Macedonia	42	8	5.27	13.6	3.08
Poland	418	171	2.44	231.8	1.80
Romania	165	65	2.53	88.2	1.87
Slovakia	231	27	8.43	44.2	5.23
Slovenia	9	19	0.46	33.8	0.27
Turkey	869	92	9.46	97.9	8.88

**Table 15.9**  
Ukraine's actual and potential exports. CIS countries

Trade partner	Ukraine's actual exports	Ukraine's exports in comparison with EU countries		Ukraine's exports in comparison with CEEC countries	
		Ukraine's potential exports	Ratio of actual exports to potential	Ukraine's potential exports	Ratio of actual exports to potential
Total	4497	684	6.57	756	5.95
Armenia	12	3	3.85	4.0	2.97
Azerbaijan	41	7	5.79	6.8	6.07
Belarus	272	31	8.64	83.9	3.24
Georgia	38	6	6.71	5.8	6.57
Kazakhstan	77	10	7.85	6.2	12.39
Kyrgyz Republic	6	1	4.79	1.3	4.51
Moldova	176	463	0.38	481.1	0.37
Russia	3516	151	23.36	157.9	22.26
Tajikistan	97	1	89.76	1.3	76.59
Turkmenistan	148	5	28.05	3.5	42.79
Uzbekistan	114	6	18.06	4.6	24.94

**Table 15.10**  
Ukraine's actual and potential exports. Asia

Trade partner	Ukraine's actual exports	Ukraine's exports in comparison with EU countries		Ukraine's exports in comparison with CEEC countries	
		Ukraine's potential exports	Ratio of actual exports to potential	Ukraine's potential exports	Ratio of actual exports to potential
Total	1310	567	2.31	138	9.52
China	629	237	2.65	35.4	17.78
Hong Kong	3	19	0.16	9.9	0.30
India	168	129	1.31	31.4	5.35
Indonesia	77	34	2.25	6.2	12.34
Korea	146	48	3.04	17.8	8.20
Malaysia	16	14	1.16	5.1	3.15
Pakistan	30	28	1.06	11.7	2.56
Philippines	78	21	3.65	5.4	14.53
Singapore	71	11	6.34	6.2	11.43
Thailand	92	25	3.61	8.5	10.79

**Table 15.11**  
Ukraine's actual and potential exports. Middle East

Trade partner	Ukraine's actual exports	Ukraine's exports in comparison with EU countries		Ukraine's exports in comparison with CEEC countries	
		Ukraine's potential exports	Ratio of actual exports to potential	Ukraine's potential exports	Ratio of actual exports to potential
Total	684	228	3.01	172	3.97
Egypt	221	42	5.23	26.8	8.24
Iran	91	44	2.09	27.6	3.29
Iraq	0	45	0.00	29.4	0.00
Israel	106	26	4.02	31.2	3.40
Kuwait	0	10	0.00	11.9	0.00
Libya	2	10	0.20	14.0	0.14
Saudi Arabia	36	2	16.96	3.1	11.72
Syria	160	13	12.04	10.7	14.98
United Arab Emirates	68	35	1.92	17.7	3.84

**Table 15.12**  
Ukraine's actual and potential exports. Africa

Trade partner	Ukraine's actual exports	Ukraine's exports in comparison with EU countries		Ukraine's exports in comparison with CEEC countries	
		Ukraine's potential exports	Ratio of actual exports to potential	Ukraine's potential exports	Ratio of actual exports to potential
Total	96	110	0.87	62	1.54
Algeria	0	22	0.00	15.0	0.00
Congo	0	1	0.00	0.8	0.00
Ghana	0	4	0.00	2.0	0.00
Kenya	3	5	0.56	2.6	1.15
Morocco	61	17	3.62	9.6	6.39
Nigeria	0	13	0.00	5.4	0.00
Senegal	0	3	0.00	1.6	0.00
South Africa	6	22	0.27	7.5	0.80
Sudan	0	6	0.00	3.8	0.00
Tanzania	0	4	0.00	2.1	0.00
Tunisia	26	11	2.36	10.9	2.38
Zambia	0	2	0.00	0.9	0.00

**Table 15.13**

Ukraine's actual and potential exports. South America

Trade partner	Ukraine's actual exports	Ukraine's exports in comparison with		Ukraine's exports in comparison with	
		EU countries		CEEC countries	
		Ukraine's potential exports	Ratio of actual exports to potential	Ukraine's potential exports	Ratio of actual exports to potential
Total	188	216	0.87	58	3.24
Argentina	8	27	0.30	7.5	1.07
Brazil	75	65	1.16	14.4	5.19
Chile	13	10	1.35	3.1	4.19
Colombia	12	16	0.76	4.6	2.63
Costa Rica	0	5	0.00	1.6	0.00
Ecuador	11	5	2.35	1.5	7.20
Mexico	51	51	1.01	12.7	4.00
Peru	0	10	0.00	2.9	0.00
Venezuela	8	16	0.50	5.7	1.40
Cuba	10	13	0.77	3.9	2.57

## **Part IV**

# **WTO Membership and Implications for Agricultural Policy**

## 16 Ukraine's Accession to WTO and the Agricultural Sector

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The purpose of this article is to provide evaluation and vision, from the perspective of the agricultural sector, why Ukraine needs to accede to the WTO, and to analyze what has already been achieved, what problems arise on the way to accession and what are the prospects for the future.

The accession of Ukraine to the WTO in the area of agriculture, without any doubt, has both positive and negative implications. Nowadays, there is no single shared vision among agrarians of Ukraine as regards the country's aspirations to accede to the WTO. On the one hand, both substantiated and perceived negative implications of the accession are often projected, and, on the other hand, there are groundless and rosy prospects for the country's economy. In our view, the issue of Ukraine's accession to the WTO and evaluation of expected implications requires a more detailed study and a better awareness of this issue by our society at large.

I would like to elaborate on the issue of expediency or non-expediency of Ukraine's accession to the WTO and consider both positive and negative implications for Ukraine in this respect. Firstly, Ukraine cannot remain outside this influential organisation and we know it for a fact. Moreover, we cannot isolate ourselves from international cooperation in the area of shaping a contemporary food system given our huge agricultural and industrial potential the capacity of which should be maximized in the interests of our state and the whole international community.

Secondly, another important condition for Ukraine's gaining membership in the WTO is the need to bring its policy in compliance with all the agreements of this organisation without any exceptions. The WTO is such an organisation whose member-countries must accept all its requirements; otherwise they are not allowed to gain the membership. We consider this as a positive factor, since, among other things, it will encourage the agricultural sector to harmonize Ukraine's legislation regulating the development of this industry and, generally speaking, it will help



Ukraine to become a state with a market economy in the full meaning of this word.

In our view, the above-said relates especially to an agrarian sector and, in the first turn, it implies the creation of environment for its further development. Due to different reasons, mostly political ones, this industry is, in fact, one of the most backward among other industries, and its way towards the market economy is full of difficulties, therefore, it suffers a great deal from it.

Thirdly, the harmonisation of legislation, which is the issue that the Government and the Verkhovna Rada are actively addressing now, will help provide a free flow of capital, loans, technologies and participation in the international distribution of labor. And this is very important for Ukraine's agricultural sector and for economics of modern agriculture since it needs significant investments for modernisation of production as well as for replenishment of working capital at the expense of loans that are badly needed in our domestic market.

Fourthly, I would like to add to the previous point that capital investments into the agricultural sector have a fairly high degree of economic return in Ukraine. We are certain that Ukraine's accession to the WTO will substantially enhance the competitive environment within the internal agricultural market. We consider that sound competition will be an additional driving force for further development of the food market. Ukraine should overcome this illness. Now we have to come up with the right diagnosis for this economic illness. But taking preventive measures could be the best choice. Therefore, we should not be afraid of enhancing competition on the domestic market, on the contrary, we are sure that it will be one of the crucial components in a stage-by-stage development of our national agriculture.

At present Ukraine's agricultural sector needs, as a gulp of fresh air, to get access to external markets, which should become one of the main factors for an economic growth of the industry. Low purchasing power of Ukrainian households is the main factor that restricts the current development of Ukraine's agriculture. Regrettably, a considerable share of its production is not in demand on the domestic food market. It was not so long ago that the agricultural production of Ukraine was mainly oriented towards the markets of the former Soviet Union. The latter had suddenly crumbled due to a number of reasons and following that collapse Ukraine lost a significant part of its markets. Last year, for example, a share of CIS countries in the overall volume of Ukraine's agricultural exports made up only 40%. Generally speaking, over the past 10 years agricultural exports to the countries of the former Soviet Union have declined by nearly USD 3 bn. It is a very big decline, and under such circumstances it is necessary to drastically change the structure of production as a whole and make changes in export and import policy, which demands considerable additional expenditures.

Ukraine has a fairly high agricultural potential and a high intensity of production (in the 90-ies Ukraine produced just as much food per capita as the most advanced

countries of the world). Therefore, the loss of traditional markets (especially markets for grain, sugar, oil, spirits, elite seeds and foods of animal origin) has had a negative impact on the overall economic situation in the agricultural sector. We believe that in view of such circumstances Ukraine's membership in the WTO will facilitate the access of Ukrainian products to the international food markets and will help the country gain the status of the most favored nation treatment in external trade. Regulation of export-import operations, improvement of veterinary, sanitary and animal quarantine control as well as other mechanisms of tariff and non-tariff regulation is in the focus of our attention. We're doing everything possible to bring all our legislative acts related to these issues in compliance with the principles of the WTO. Nowadays, nearly 95% of all customs tariffs have been agreed upon and we keep improving our legislation, especially in the area of non-tariff methods of regulation.

Over the recent years some fundamental measures have been taken in Ukraine's agricultural sector with a view to introduce private ownership in agriculture and food industry. These processes are almost over. The enterprises have undergone in-depth restructuring, the market infrastructure has been given a new boost; up-to-date economic methods for regulation of the agricultural market and providing support to the development of agriculture, which are in line with the principles of WTO, have been implemented. It should also be pointed out that Ukraine is not seeking accession to the WTO as a pleader or as a beggar. Even in the toughest periods of the country's economic history Ukraine never had a negative balance in its export-import operations with agricultural produce, and over the two previous years the export of Ukraine's agricultural output has grown 1.6 times. This points to the success of our agricultural production in the international food market and its competitiveness.

Within the overall structure of Ukraine's export the agricultural output accounts for 13-14%, which is considerably higher than in many advanced countries that are members of WTO. According to our projections the share of agricultural production in the overall export of Ukraine will continue to rise. Last year Ukraine joined the group of five biggest exporters of grain. Ukraine is winning back its position that it had enjoyed in the recent past. Ukraine has a good export potential in oil and fat produce, cattle-breeding production and in many other kinds of produce.

We are certain that, overall, Ukraine has competitive advantages on external markets, and, therefore, we'll continue to implement measures aimed at increasing the export potential of its agricultural sector in the future. High ecological standards of our produce, competitive prices, a convenient geographical position of our country and many other factors will contribute to it.

Let me also point out that such changes are positively perceived by international organisations and by the majority of the WTO member-countries, and we constantly feel it. However, we are also aware of the fact that Ukraine still lacks a

sufficient market environment, which would be conducive to further shaping of a competitive agricultural sector. A large amount of work still has to be done regarding improvement of legislation and addressing a whole range of other issues. Here are some of the main problems on the agenda:

Firstly, the land as an underlying element of the agricultural reform and a critical element for shaping an integral and full-fledged agricultural market has not yet been involved into an economic turnover. An agricultural land market will only be launched in the year of 2005. Therefore, a very active work is carried out now with a view to finalize the land legislation, which will allow us to successfully complete the land reform.

Secondly, a mention should be made of insufficient state budget as well as of the vagueness of the budget policy as regards its support to the agricultural sector. Weakness and scarcity of bank lending prevent us from providing an effective state support, which would not be in conflict with the WTO requirements, and exercising a viable regulation of the agricultural market. In a nutshell, such a situation does not contribute to the enhancement of competitiveness of Ukraine's agriculture. On the contrary, it generates new problems in the context of the future liberalisation of trade on the food market. But, as we know it, ensuring sustainable income of agricultural producers is one of the conditions of the WTO Uruguay agreement on agriculture.

According to the academic estimates, Ukraine's domestic food market makes up approximately UAH 90 bn (nearly USD 18 bn). So one does not have to be a great mathematician or economist to calculate a minimum need in state support, at least at such a level that exists in the neighboring countries. Regrettably, in the course of negotiations on Ukraine's accession to the WTO such countries as the USA, Canada, Australia and some others urge Ukraine to reduce the existing support to its agriculture, which is very small as it is. It goes without saying that such a policy will further reduce its competitiveness on the international market.

We are also aware of the fact that it is necessary to address some other problems related to raising competitiveness, such as diversification of production and improvement of technologies, cost reduction, raising productivity of each hectare of land, increasing cattle productivity, environmental protection and a whole range of other parameters. But these are mostly internal problems that we have to cope with. At present the Ministry of agricultural policy and other bodies of executive power and economic institutions are working hard to resolve the above-mentioned problems.

The agricultural sector has been playing an ever more increasing role in Ukraine recently. Thus, in spite of tax benefits granted to agriculture the share of agricultural sector, agricultural and food enterprises in the revenues to the budget comes second after the oil and gas industry.

It is also worth mentioning that according to academic assessments the activity of each agricultural worker in Ukraine creates jobs for 7-8 workers in other areas of the national economy, i.e. agriculture today acts as sort of a multiplier for the growth of the whole national economy. Therefore, agriculture expects (probably for good reason) a fair amount of attention on the part of the state and an adequate level of support it needs for its development. Regrettably, there is neither so far. We are aware of all the objective reasons for that, but I believe that statements of the new government inspire us with hope that such issues will be dealt with in a more effective way.

Now we have come up with definitive undertakings concerning support to agriculture, and such undertakings do not contradict the WTO requirements. The size of total direct support to the industry, according to experts' calculations, should not exceed USD 1.38 bn, which will have to be reduced by 13% within the next ten years. It should also be noted that the Ministry of agricultural policy will continue to stand for such volume of agricultural production as was determined in calculations for the base period of 1994-1996. This has been stressed many times during multilateral negotiations. For comparison, the underlying level of support for such countries as Poland and Finland was determined in the amount of USD 4.2 bn. If one compares the production capacities and the volume of agricultural production in Ukraine with those in the above-mentioned countries, the contrast is obvious. It should be emphasized that one of the main principles of the WTO is the principle of fairness and, in our view, the WTO member-countries should probably be more consistent on this issue. Moreover, countries with less developed economies should enjoy certain privileges, such as tariff regulation of imports, time frame for reduction of tariff regulation, appropriate transitional period to adapt their economies to the international market environment. What I mean is that our negotiation process and relationships should be built on a more pragmatic economic attitude rather than on politics, which, to our regret, seems to prevail today.

It is evident that Ukraine consistently continues to take steps in order to accede to the WTO, specifically making progress regarding agriculture. We expect the signing, in the nearest future, of the general protocol on Ukraine's accession to the WTO.

At the same time it should be also stressed that we are aware of the fact that much remains to be done to continue reforms in Ukraine's agricultural sector and introduce the up-to-date and effective mechanisms of state support for the industry's competitive development. Consolidation of efforts of all branches of power, which has recently taken shape, consolidation of our joint efforts alongside with the regions, agricultural science and technology, support from international organisations is a crucial factor. It will allow us to successfully address all the challenges that Ukraine faces in its accession to such an influential organisation as the WTO. This will be a civilized process in the interests of all stakeholders on the

agricultural market, in the interests of the state and international community and without any tangible losses.

# 17 The Doha Round: A New Agreement on Agriculture?

James D. Gaisford<sup>113</sup> and William A. Kerr<sup>114</sup>

## Abstract

Ukraine, and other countries negotiating accession to the WTO, will ultimately have to conform to the requirements of the multilateral trading system. Trade in agricultural products, however, was only partially incorporated into the GATT system in the Uruguay Round. Since efforts are under way, now in conjunction with the wider Doha Round of negotiations, to bring agriculture closer to the norms of the international trading system, Ukraine faces a moving target. Consequently, this paper endeavours to provide some guidance on the likely directions for the agricultural trade regime.

## 1 Introduction: why bother with the WTO?

An agreement reached between the US, Canada and the European Union on the EU tariff regime for grains sets the stage for formal consultations with Russia and Ukraine, which are likely to object to a new tariff-rate quota under the agreement which will sharply curtail their exports of low and medium quality wheat even as it leaves North American untouched.

The EU has partnership and cooperation agreements with those two countries, which obligate it to give them equal treatment with respect to what it grants other trading partners and to consult on changes to its tariff regime. But the consultation requirement *does not entail any obligation upon the EU to modify its proposed*

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*regime to meet the demands of Russia and Ukraine*, the EU official emphasized (emphasis added) (*Inside US Trade*, Nov 15, 2002).

This example of unilateral action taken by the European Union (EU) to protect its domestic market from imports of grains from Black Sea ports serves to emphasise the benefits of acceding to the World Trade Organization (WTO). The primary purpose of the WTO is to protect firms wishing to engage in international commercial transactions from the capricious use of trade barriers by governments to provide domestic vested interests with protection from foreign competition (Gaisford and Kerr, 2001). As Ukraine is not a member of the WTO, the EU can unilaterally change its tariff bindings on imports from Ukraine (*Inside US Trade*, Nov. 8, 2002). This is exactly the type of protectionist activity that membership in the WTO will mitigate.

While the benefits of acceding to the WTO are clear at least in principle, how to prepare for WTO accession is less obvious. Preparation is necessary because domestic policies must be refashioned to conform to WTO norms. Preparation is important because it takes resources to change policies and because policy reform will affect firms that have made investments based on the existing policy regime. Thus, governments must commit resources to the preparation for accession and firms must make investment decisions in anticipation of the trade regime that will exist upon accession. When the trade regime upon accession is not transparent, governments risk an under or over-commitment of resources in the lead up to accession, while firms face increased risks in making investments to position themselves to take advantage of the opportunities presented by accession. Lack of transparency increases the probability that government resources will be wasted and that there will be under-investment in trade related activities. International commercial opportunities will be foregone. Thus, it is important to attempt to discern what the WTO trade regime is going to look like upon accession.

The future form of the international trade regime is clouded in considerable uncertainty because many — but not all — of the WTO-administered agreements are currently being renegotiated. The WTO Agreement on Agriculture (URAA) and the General Agreement on Trade in Services (GATS) were both opened for further negotiation in early 2000 as stipulated at the conclusion of the Uruguay Round. In November 2001, a new round of general multilateral trade negotiations was launched at the Doha Ministerial Conference of the WTO, and the agricultural and service negotiations were brought under the broader umbrella of the *Doha Round*. Very significant differences in the negotiating positions of key players have contributed to the lack of transparency in at least three ways. First, there is little consensus with respect to the future shape of the international trade regime itself, especially with respect to agriculture. Second, there is doubt when a new WTO regime will be in place. While the current WTO negotiations include specific deadlines, there is little confidence that the timetables can be kept to. Experience from past *Rounds* of General Agreement on Tariffs and Trade (GATT) negotiations suggests that they will not. Finally, the current *Round* may end in

failure. For all these reasons, the task of preparing for accession is extremely difficult for both governments in prospective member countries and their firms.

## 2 Agriculture: trade without rules

Opaqueness is greatest in the negotiations surrounding agriculture. This is because the rules for trade in agricultural products are in the process of being integrated into the set of WTO disciplines that are applied to most other traded products. As a result, in addition to the progress toward liberalisation that can be expected from trade negotiations, for agriculture there is the need to move to convergence with general WTO norms.

Until the Uruguay Round of GATT negotiations that were completed over the 1986-1994 period, trade in agricultural products was, for the most part, conducted outside the normal GATT disciplines that restrict each government's ability to extend border protection and put in place other trade distorting measures such as subsidies. This is because in the early days of the GATT the United States insisted on *waivers* being granted for trade in agricultural products. Agriculture interests in the US, and most developed market economies, represent strong lobbies with considerable political power. Unlike the industrial and service sectors of most developed economies, agriculture is a declining sector and, in particular, has been shedding labour for at least a century. The force driving this exit is technological change which, while not characterised by the *drastic* changes that attract attention in other sectors, has been relentless in providing increases in productivity.

In developed economies, much of the labour in agriculture is comprised of small, owner-operated businesses — family farms. Shedding labour is particularly difficult under this industrial structure because it entails bankruptcy (rather than just unemployment) and the loss of family dwellings. While unemployment in urban areas may require relocation, often it does not. Given that typically, alternative rural employment opportunities are scarce, exiting from farming almost always entails relocation and, thus, the costs associated with a loss of a familiar community. There may also be negative externalities imposed on those that remain in rural communities such as closures of local schools and hospitals (Leger et al., 1999).

The farm policies of developed market economies have had one common objective — to slow the pace of exit. If the most important domestic policy objective is to slow the pace of exit from the farm sector, and trade policy is an adjunct to the domestic policy objective, then trade must be viewed in a new light. In the “reduce the exit of labour from agriculture” mode of thinking, exports (including subsidised exports) are *good* because they allow more production and keep more people employed in the sector. Similarly, imports are *bad* because they



compete with, and hence reduce, domestic production with adverse consequences for the retention of labour. The *waivers* insisted on for agriculture products in the pre-Uruguay Round GATT reflect this subjugation of agricultural trade policy to domestic agricultural policy priorities. Whereas, general GATT disciplines accepted the principle of *tariffication*, agricultural waivers allowed the continued use of import quotas and variable levies to limit market access. In many circumstances these border measures inhibit market access to a greater degree than tariffs and are typically less transparent, meaning they are harder to compare during negotiations. Further, export subsidies are not allowed under general GATT disciplines but were allowed for trade in agricultural products. In the GATT, domestic subsidies are either non-actionable (*green*) and allowed without limit or actionable (*amber*) and restricted to a maximum of 5% of the value of the good. In agriculture, prior to the Uruguay Round, domestic support was not constrained.

With no constraints on the use of trade distorting policies in agriculture and the relentless pressure of technological change on domestic agricultural populations, governments responded by continuing to restrict market access and to provide farms with subsidies. In the European Union, in particular, the restrictions on access not only slowed the exit of farmers but unleashed unprecedented investments in productivity enhancements that increased supply. This supply increase was sufficient to move the EU from a net import basis for most commodities to being in a surplus situation (Gaisford and Kerr, 2001). Initially, attempts to deal with the surpluses (thought to be temporary) centred on storage but the surpluses soon proved systemic and the stocks expensive to hold and ultimately proved unmanageable. The EU's policy soon refocused on export subsidies. This meant its subsidised products competed directly in the traditional markets of the major agricultural exporters such as the US, Canada, Australia and Argentina. In the 1980s this led to a major *tit for tat* subsidy war between the US and the EU. The result was declining international prices and escalating budgetary demands. Further, export subsidies had to be backed up by restrictions on access to EU markets – usually variable levies that increase instability in international markets. The latter was particularly detrimental for developing countries. The dispute over agriculture considerably soured relations between the EU and the US and these tensions began to spill over into other aspects of their bilateral relations.

### 3 Agriculture in the Uruguay Round

The issue of agricultural trade came to the forefront during the Uruguay Round. The major outcome of the Uruguay Round was the acceptance that agriculture must come under general GATT disciplines, albeit with an unspecified transition period (Gaisford and Kerr, 2001). The first phase of the transition process was

also negotiated during the Uruguay Round. In the URAA, commitments were made for all three *pillars* of agricultural trade reform: (1) tariffication and enhanced market access; (2) the reduction of export subsidies as a first step toward eventual elimination; and (3) the reduction of actionable domestic subsidies. By judicious selection of base years upon which calculations would be based and the creation of a new subsidy category (known as the *blue box*), the actual reductions in subsidies were not substantial. The important point is that they would no longer increase, thus breaking the *tit for tat* subsidy spiral.

In terms of market access, what was agreed was that quantitative restrictions and non-tariff border taxes (e.g. variable levies) would be subject to tariffication. Given that there was no standardised method for how other border measures should be converted to tariffs, many countries converted at extremely high tariff levels — a practice known as *dirty tariffication*. Further, for some commodities where *dirty tariffication* threatened the existing market access provided by import quotas, a new import restricting measure called a tariff rate quota (TRQ), or sometimes simply a tariff quota, was allowed. Up to a quantitative limit, tariff rate quotas allow goods to enter a customs territory at a low, or zero, *within-quota tariff*. Imports in excess of the quantitative limit are charged much higher duties known as *over-quota tariffs*. These TRQs have, in many cases, been applied to *sensitive* (heavily protected) sectors as they tend to provide an increased degree of domestic price stability relative to tariffs. Further, as the within quota quantities can be allocated administratively, they are open to manipulation to reduce the *fill rate* (Skully, 2001).

Once tariffication was complete, it was agreed that developed countries would reduce their tariffs and over-quota tariffs by an average of 36% over six years. While each commodity was subject to a minimum tariff cut of 15%, this still left ample room for high levels of tariffs to remain for some politically sensitive commodities as long as greater reductions were made elsewhere. Developing countries were subject to lower reduction of 24% over 10 years with a minimum tariff cut of 10% per commodity. Least Developed Countries, as defined by the United Nations, were not required to lower tariffs.

In terms of export subsidies, it was agreed that developed countries would reduce total outlays on export subsidies by 36% and trade volumes subject to subsidies by 21% over six years. Developing countries agreed to reduce their export subsidies by 24% by value and 14% by volume over ten years. Once again, these reductions were average reductions so that high levels of export subsidies could remain for sensitive commodities provided that greater reductions were made on other commodities.

Domestic actionable subsidies were to be reduced by 20% by developed countries and 13% by developing countries. However, this commitment was modified, primarily to the benefit of the European Union through the creation of the *blue box* of subsidy programs that were exempted from inclusion in the base figure — the

aggregate measure of support — upon which the subsidy reduction calculations would be made. Blue box subsidy programs must incorporate limits on output. Further, countries were allowed to convert support from actionable subsidies to non-actionable subsidies. The EU and the US did a great deal of subsidy conversion and, in the EU case, expenditures actually increased after conversion. The URAA also included a provision, known as the *peace clause*, by which countries agreed not to impose countervailing duties or take other actions against the domestic subsidies of their trade partners until the end of 2003.

The Uruguay Round also included several other WTO-administered agreements beyond the URAA that are highly relevant to agriculture. The most important of these are the Agreement on Sanitary and Phyto-Sanitary (SPS) Measures and the Agreement on Technical Barriers to Trade (TBT). The SPS Agreement allows measures designed to protect animal and plant safety and human health, but it endeavours to prevent disguised protectionist measures. Similarly, the TBT Agreement attempts to allow for standards and labeling pertaining to food and other products, where consumer protection or product information is important, without allowing concealed protectionist measures that arbitrarily discriminate against foreign products.

## **4 Why is agriculture an issue in the current negotiations?**

The Uruguay Round agricultural negotiations themselves were extremely difficult. Fundamental disagreement between the US and EU, especially over export subsidies, repeatedly threatened to scuttle the entire Uruguay Round trade negotiations and ultimately forced their extension. The US, backed by the Cairns group of agricultural exporting countries, strove for the total elimination of export subsidies, while the EU adopted a gradualist position. On market access, the EU along with Japan again favoured a more gradual position. While it is clear that a gradualist approach was generally adopted after extremely arduous and protracted negotiations, it was also agreed in Article 20 of the URAA that negotiations on agriculture centred on market access, export subsidies and domestic support would be reopened, after a respite, in 1999/2000.

The Uruguay Round also failed to deal adequately with a number of issues that are now affecting the agricultural sector. Only limited progress was made on anti-dumping procedures that are particularly grievous in agriculture (Gaisford and Kerr, 2001). In the period since the Uruguay Round negotiations were completed, a number of new issues have arisen that are putting stress on the agricultural trading system. Rising consumer concerns over food safety, the environment and animal welfare have not been dealt with in the new WTO framework to the

satisfaction of some countries. In particular, the WTO provides no means by which domestic politicians can respond to consumer requests for protection (Perdikis et al. 2001). This issue has become heated in the wake of the commercialisation of agricultural biotechnology, which is largely a post-Uruguay Round phenomenon. Consumer resistance is also at the heart of the EU's refusal to abide by the ruling of a WTO disputes panel that it should open its markets to beef produced using growth hormones (Kerr and Hobbs, 2002).

Some countries have been pushing the concept of *multifunctionality* in the context of subsidy expansion under the misnamed rubric of *non-trade concerns*. Multifunctionality is an attempt to explicitly recognise that farming, in addition to producing food and fibre commodities, also produces environmental and other amenities – often without compensation (Rude, 2001). Given that this represents a market failure, multifunctionality's advocates, particularly in Europe and Japan, feel that governments should be allowed to correct the failure.

Finally, due to dirty tariffication, the advent of TRQs and the ability of developed countries to average their reductions in subsidies, many developing countries believe they were duped in the Uruguay Round in the sense that they have not received the increased market access to developed country markets that they expected. At the Seattle and Doha Ministerials they forcefully made it known that they wished this duplicity to be redressed. This has led to the new Round's public focus on development.

Despite the failure of the Seattle Ministerial Conference to launch a millennium round of general trade negotiations in November 1999, the WTO member states re-commenced negotiations on agriculture in 2000 as previously agreed in the URAA. These negotiations began earlier and independently from the broader round of negotiations agreed at the Doha WTO Ministerial in November 2001. As mandated in the URAA, the agricultural negotiations were centred on the three pillars of trade distorting agricultural policies — market access, export subsidies and domestic support. The Doha Ministerial Declaration reaffirmed that objectives concerning “substantial improvements in market access; reductions of, with a view to phasing out export subsidies; and substantial reductions in trade distorting domestic support (WTO, 2002b, 13).” The Doha mandate has also officially reaffirmed that the agricultural agenda is to include the special and differential treatment of developing countries and non-trade concerns, although the latter remain only vaguely defined. Deadlines have also been imposed. By March 31, 2003, there is supposed to be agreement on modalities, which include negotiating parameters, formulae, and numerical targets (WTO, 2002a). Further, the URAA negotiations are supposed to wrap up with the other negotiations by January 1, 2005.

It is important to note that negotiations on dumping and anti-dumping duties are taking place as part of the broader Doha agenda outside of the agricultural negotiations. Agricultural-related environmental issues have also been devolved to

the WTO's Committee on the Environment to determine the relationship between Multilateral Environmental Agreements (MEAs) and the WTO. One of the most crucial MEAs is the Biosafety Protocol which was negotiated to regulate trade in the products of biotechnology but has rules pertaining to trade that directly conflict with existing WTO norms (Isaac et al., 2002). Moreover, the Agreement on Sanitary and Phytosanitary Measures (SPS) and the Agreement on Technical Barriers to Trade (TBT) where food safety and other consumer issues could have been discussed were not re-opened for negotiation in the Doha Ministerial. This has left further important issues concerning biotechnology largely off the agenda.

In terms of the three pillars of the URAA mandated negotiations, there is clearly a great deal yet to be done to reach the WTO norms. Tariffs remain much higher than are found in other sectors and some tariff spikes associated with sensitive commodities are extremely high. Tariff Rate Quotas have only been granted as a transitional measure and should be slated for further liberalisation. 64% of the value of pre-Uruguay Round export subsidies remain. Domestic levels of support in the actionable category were only reduced 20% and remain far in excess of the 5% *de minimis* levels that constitute the WTO norm. The blue box, which is considered by some countries as temporary, is also the subject of negotiation. Further, some countries want the negotiations expanded to non-trade concerns such as multifunctionality, animal welfare and the use of the precautionary principle in food and environmental safety. The latter pertain directly to the debate surrounding trade in products derived from the use of biotechnology. The attempt to have them included in the URAA talks stems from the failure to re-open the SPS and TBT agreements and the absence of a WTO consensus on how environmental issues are to be treated in international trade agreements.

It is clear that there is a wide range of economically important and complex issues pertaining to trade in agricultural products that need to be addressed in the current round of international negotiations. There is little commonality of interest among the major parties — either individual countries or groups of countries. This is different from the Uruguay Round where all of the major players except Japan and import dependant developing countries had an interest in stopping the *tit for tat* subsidy war between the EU and US. The US and the EU wished to reduce their budgetary expenditures on agricultural support and to reduce the spillovers that the animosity over agricultural subsidies was creating for other aspects of their relations. The Cairns group of agricultural exporters and as well as a large group of developing countries interested in expanding their domestic agricultural sectors were suffering from the low international prices arising from competing export subsidies. This convergence of interests was sufficient, after a considerable period, to prevail in the Uruguay Round. No such convergence of interests yet exists for the current negotiations.

## 5 Wish lists and closely held cards

The mandated URAA negotiations commenced more or less on schedule but the start was delayed a little by the failure to launch a new broad round of negotiations at the failed Seattle Ministerial in late 1999. As is typical in these types of negotiations, countries initial positions represent *wish lists* or extreme positions from which everyone knows there must be movement. These initial positions have been chronicled elsewhere (Hobbs and Kerr, 2000) and can be summarised briefly. The initial positions reflect the countries' state of affairs at the end of the Uruguay-Round implementation period for developed countries.

The Cairns group of agricultural exporting countries that do not use export subsidies, along with the US, take the position that all export subsidies should be eliminated and this should be done as quickly as possible. The EU, the largest user of export subsidies, is vaguely in favour of further reductions similar to those agreed in the Uruguay Round. The EU, however, has tied any reductions on export subsidies to a more comprehensive discussion that also includes disciplines on export credits and food aid, both of which can be used as alternatives to directly subsidising exports. Developing countries are split over export subsidies. Developing countries that are exporters of agricultural products generally want export subsidies eliminated so as to reduce subsidised competition from developed countries. Meanwhile those that are net importers are concerned with potential price increases once the subsidies are removed and with access to future food aid. Japan, backed by other importing countries, has voiced concern over the possibility that export restrictions could potentially be imposed that would disrupt food supplies, especially in times of shortage. Export restrictions could, thus, be converted to taxes and be subject to reduction commitments much like tariffs.

Market access positions are also predictable. The US has proposed maximum limits for tariffs that would effectively mean that high tariff customs areas such as the EU would be forced into large reductions while low tariff countries would have only small adjustments. Countries with low barriers to market access also propose that the ability to average reductions in tariffs, and thus continue to protect *sensitive* industries, should be eliminated or reduced. A focal point in this discussion is the so-called *Swiss formula* that would subject high tariffs to greater cuts. To ensure that new cuts are really made, the US has also suggested that cuts be based on actual tariffs rather than bound tariffs, which are often higher, but this would unduly penalise countries that really have exceeded their Uruguay Round commitments.

Countries with high import barriers, meanwhile, have suggested Uruguay Round style percentage cuts and the continuation of averaging. Ironically, Switzerland is one of these countries; although it introduced the idea for manufacturing tariff cuts in the Tokyo Round, Switzerland does not support the use of the "Swiss formula" in the current agricultural negotiations (WTO, 2002). The Uruguay-Round

approach, of course, would mean that tariff spikes could be retained. In a paper issued on market access, Japan has indicated that it wishes only the most conservative liberalisation. It suggests that tariffs follow the Uruguay Round method of averaged percentage cuts starting from bound tariffs. Since bound tariffs often reflect the *dirty tariffication* after the Uruguay Round, tariffs officially could be reduced without actually increasing market access.

A group of eleven transition countries who are WTO members — Bulgaria, Croatia, the Czech Republic, Estonia, Georgia, Hungary, the Kyrgyz Republic, Latvia, Lithuania, the Slovak Republic and Slovenia — have argued that exposing their agricultural sectors to further competition from imports at this point would cause serious disruption (WTO, 2002b, 23). Some developing countries have raised the issue of tariff escalation whereby processed foods are often subject to higher tariffs than raw products. Such tariff structures, which are often found in developed countries, provide effective protection to food processing that exceeds the apparent nominal tariff rates and constrains the growth of downstream processing industries in countries that export the raw products. Clearly, this tariff escalation issue is of potential importance to many transition countries — whether they are current or future WTO members — including Ukraine.

In terms of TRQs, the US suggests the elimination of within quota tariffs and a 30% increase in TRQ quotas, which would leave its sensitive industries such as sugar and citrus untouched (i.e. no increase in market access). This is because the import demand for these products is sufficiently large relative to the current TRQ quotas that the proposed increases in the quotas will not affect the domestic price. Rather, the domestic price will continue to be determined by the over-quota tariff (Gaisford and Kerr, 2001).

The other issue raised about TRQs — their administration — has relatively straightforward *economic* solutions (Gaisford and Kerr, 2001). The contention of the United States is that administrative allocation prevents the quota portion of TRQs from being *filled* in some cases. The economic solution would be to use market mechanism such as auctions for their allocation. This would have the added benefit in the case of developing and transition countries of providing increased government revenue and fewer opportunities for corruption. Further, it would reduce the potential for breaching the non-discrimination principle of the WTO. Not surprisingly, the *political economy* of reforming TRQ administration has been much more difficult because those who receive the rents from being favoured with allocations under non-market rules have much to lose.

One solution to reducing the economic inefficiencies that arise from non-market allocation of TRQ quotas while avoiding many of the political difficulties would be to insist that regardless of the allocation method, these rights could be traded once allocated. This would create a secondary market whereby the most efficient exporters would become a market's suppliers. It would seem that TRQ administration might be something on which the major players could agree. The

EU has advocated increased transparency, but it remains to be seen if it is really ready to abandon its tradition of using administrative measures to discriminate in favour of certain countries or firms.

The Cairns group has put forward a strong position on the reduction of domestic subsidies suggesting both a reduction to *de minimis* levels and a reduction in the *de minimis* level below the existing 5% of the value of a good for actionable subsidies. Canada has proposed a cap on the total value of domestic subsidies including those in the non-actionable green box and those in the blue box. The US also wants a reduction to *de minimis* levels on actionable subsidies as well as closure of the blue box. The large increase in subsidies embodied in the 2002 US Farm Bill, however, has considerably reduced US credibility over the issue of domestic subsidies.

The EU wants the list of non-actionable subsidies expanded to include payments for multifunctional activities of farmers and for increased animal welfare standards. In these cases, Norway and Switzerland have backed the EU. A large number of both developed and developing countries, however, have rejected the position on animal welfare (Hobbs et al., forthcoming). Meanwhile, India and some other developing countries have suggested that domestic subsidies should be restricted to use by developing countries in a *development box* (Von Braun et al., 2002).

A group of twelve transition countries consisting of Albania, Bulgaria, Croatia, the Czech Republic, Georgia, Hungary, the Kyrgyz Republic, Latvia, Lithuania, Mongolia, Slovak Republic and Slovenia has requested extra latitude with respect to domestic subsidies (WTO, 2002b, 23). In addition to a higher 10% *de minimis*, they wish to have additional allowable support measures particularly with respect to the provision of credit and debt and interest forgiveness because of weak financial markets.

A wide variety of divergent views have been expressed with respect to the peace clause. Some countries want the peace clause extended beyond its scheduled expiry date at the end of 2003, while others want it to lapse completely and still others want it to continue to protect green-box subsidies only or developing countries only.

Since the initial positions have been put forward, little progress has been made. In part this is a function of the current "modalities stage" of the negotiations. Nevertheless, the EU and Japan, in particular, have remained quite circumspect in making concessions and moving beyond their initial positions. As a result, it appears that other countries have also been very reticent to make known their negotiating offers. In fact, the negotiations do not yet exhibit much consensus on the modalities upon which the substantive negotiations will be based. The deadline for the modalities is in late 2002 and, Stuart Harbinson, the Chairman of the WTO Agriculture Committee who is charged with developing the modalities document has expressed considerable concern that it will be difficult to develop the



document on time. Without it, progress on substantive negotiations cannot begin, calling into question whether the negotiations can be completed by the 2005 deadline. However, many question whether the deadline is really firm, despite official protestations to the contrary. Such posturing and refusal to reveal negotiating positions is consistent with strategic behaviour and par for the course in past trade negotiations. It does, however, make it difficult to forecast the outcome.

A number of external factors will affect the negotiating positions. One very important factor is the shape of Common Agricultural Policy (CAP) reforms that will set the parameters for the EU's negotiation positions. To date the process of CAP reform has been painfully slow. Another key external factor is how the general Doha or Development Round negotiations evolve. It seems unlikely that there can be significant progress made on agriculture unless countries are able to trade off concessions in agriculture against those in other sectors. While the broader negotiations are more transparent than those in agriculture, they are sufficiently opaque that these tradeoffs cannot yet be discerned.

## **6 What does it mean for countries seeking WTO accession?**

It should be clear that little can be said with surety regarding the negotiations. As a result, preparations for accession will be difficult for governments moving toward accession and the current environment is risky for firms that need to make investment decisions. It does appear that the major players may be willing to accept less, rather than more, from the current round of negotiations, particularly if the Round is completed in a timely fashion. In part, this is because only easy issues were dealt with in the first phase which ended with the Uruguay Round while the more difficult questions were left to this second mandated stage (Kerr, 2000). Gaisford and Kerr (forthcoming) also suggest that an equilibrium in the reform of agricultural trade may have been reached and that, politically, substantial further movement by some parties may be extremely difficult. Unless there are substantive breakthroughs on important issues in the trade negotiations outside agriculture, major progress on agriculture looks increasingly unlikely.

The pillars of market access, export subsidies and domestic support are old issues whose solutions are relatively straightforward and the negotiations relate to how far and how fast. The current answer appears to be not far and not fast. Unfortunately, bigger issues that are likely to be major contentious issues in agricultural trade, in particular those relating to biotechnology (Gaisford, et al., 2001) are not even on either the URAA or the broader Doha agenda. The 'not-far, not-fast' scenario probably means some progress on export subsidies on the order

of magnitude arising from the Uruguay Round and further reductions in tariffs. Countries in transition to market-based economies may face tariff-reduction commitments, or at least extended implementation periods, that are similar to developing countries.

For TRQs, over-quota tariff reductions may well be dealt with in the same fashion as tariffs as in the Uruguay Round. The soft constraints arising from *dirty tariffication* may also be given up leaving binding reduction to future negotiations. Within quota tariffs may be significantly reduced, or put on a path leading to abolition by the end of the phase in period. There may also be limited increases in the quotas. Finally, it appears that there may be limited commitments that attempt to increase transparency for TRQ quota administration. Given the focus on development in the current round, developing countries will likely not have to submit to significantly increased disciplines under the rubric of *Special and Differential Treatment*.

Domestic subsidies represent the least transparent of the pillars. It seems unlikely that the green box of non-actionable subsidies will be expanded, while at the same time a movement to *de minimis* on actionable subsidies is equally unlikely. This suggests some modest reductions in domestic support. The fate of the blue box cannot be discerned. It will be important to keep a close watch on the ongoing CAP-reform process in the EU and its interplay with the URAA negotiations. The degree to which the EU can move domestically will inform the URAA process considerably. Whatever the general approach to domestic support, transition countries, once again, may face reduction commitments, or at least extended implementation periods, that are similar to developing countries. Finally, at least a modified peace clause may be retained.

Given these modest projections, countries in negotiations to accede to the WTO should be willing to make only modest concessions in the areas covered by the three pillars. Building in transparency for TRQ administration, state trading enterprises and other administrative measures, however, will reduce the need for further reforms and, in any case, are good public policy.

## 7 Conclusion: the way forward?

The current negotiations on agriculture at the WTO suffer from an absence of vision, a spark to motivate substantial reform and a champion. While the Cairns group have a great deal to gain from reform, their most able members, such as New Zealand and Australia, have yet to produce anything inventive in the form of a compromise to get the negotiations moving. So far, they have only suggested a self-serving and radical solution rather than an inventive compromise. Consequently, their influence is reduced considerably from the Uruguay Round

where they played a facilitator role. Their natural replacement given the orientation of the current broader WTO round, developing countries, are mired in their own protectionism where Special and Differential Treatment vies for increase market access to developed country markets as the most important negotiating point. This inability to move dramatically beyond a focus on narrow protectionism clearly represents a lost opportunity given the successful lumbering of developed countries with guilt over non-implementation of Uruguay Round commitments. The position of developing countries is transparently two-faced and will allow developed countries the option of leaving their markets closed in return for the continuing closure of developing country markets. This clearly represents a lose-lose situation for developing countries.

Japan remains largely silent. It will resist any increase in market access largely because of the potential effect of liberalisation on rural property values. Given that their economy is still attempting to deal with the bad debts associated with overvalued urban land values a decade ago, they are not willing to risk a similar decline in rural property values. The US administration, while interested in major changes in the URAA, has been hamstrung by the hypocrisy of the latest Farm Bill. The EU is entangled in the intricacies of CAP reform in preparation for the accession of new members from Central Europe in the near future. Accommodating new members is far more important to the EU than the WTO negotiations and will dominate its decision-making.

For countries such as Ukraine negotiating accession to the WTO the future shape of the URAA remains opaque. Since modest progress appears to be the most likely URAA conclusion, accession countries should concentrate on developing sound domestic policy that is broadly consistent with the existing URAA instead of trying to second guess the future direction of the WTO trade regime for agriculture. This definitely means pursuing market-based reforms that increase the transparency of domestic trade policy regimes, including the curtailment of remaining state trading agencies. On the one hand, accession countries should *not* insist on retaining the maximum protection that can be negotiated, but rather attempt to position their rural economies to be more efficient than their competitors. On the other hand, some strategic protectionist measures might reasonably be retained as future bargaining chips. One thing is virtually certain. There will be a further round (or rounds) of agricultural negotiations until the Uruguay Round vision of fully integrating agricultural trade into general WTO disciplines is realised.

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# 18 Forces Shaping the Outlook for World Grain Markets<sup>115</sup>

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## 1 Introduction

After the fall of the Soviet Union, which had absorbed large parts of Ukrainian exportable surpluses in agriculture, and years of turbulences and restructuring when Ukraine had become net importer in a number of agricultural commodities, recent years saw the re-occurrence of significant Ukrainian exports of wheat, coarse grains and other products. Even though the large exports to international markets in the last two years were partly due to some specific factors, including favorable weather conditions resulting in large harvests, and the drop in exports to the Russian Federation and other countries within the Commonwealth of Independent States (CIS), the recent developments clearly show that Ukraine has the potential to play an important role on international agricultural markets.

As such, Ukraine might well influence the future development on international trade and prices. On the other hand, as Ukraine becomes more oriented to world markets, perspectives of international commodity prices and market conditions become more relevant for this country as well.

This paper aims to shed light on the expected future of international markets for wheat and coarse grains. The first part, which gives an overview on the latest OECD market projections, strongly draws on the OECD (2002). It will provide the main assumptions underlying the forecast, as well as the main projection results until 2007. The second part of the paper makes allowances for the fact that a number of driving forces have significantly changed as compared to the assumptions in the Outlook. Therefore, current market conditions and recent changes in macroeconomic and political conditions are discussed with respect to

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<sup>115</sup> Opinions expressed in this paper are those of the author and do not necessarily reflect opinions held by the OECD or its Member countries.

their possible implications on world agricultural markets. A couple of final remarks will conclude the paper.

## **2 Main projections for world grain markets**

The market outlook to be discussed here is based on OECD (2002). It represents a set of projections to constitute a plausible medium-term future for the markets of key commodities, including grains, oilseeds, meats and dairy products. They are the result of close co-operation between the OECD Secretariat and experts in Member countries and some Non-Member Economies (NMEs) and hence reflect their combined knowledge and expertise. The OECD's Aglink model is used to guarantee internal consistency in the projections.

The projections are based on a number of assumptions relating to current or announced agricultural and trade policies in OECD countries, the underlying macroeconomic environment, and developments in major NMEs. Before discussing the main projections with a particular focus on grain markets, these assumptions therefore need to be addressed.

### **2.1 Key economic assumptions**

Major assumptions with respect to the economic environment include those on economic growth, population growth, inflation rates, and exchange rates.

The recent past has seen a considerable slowdown in economic growth that spread to numerous OECD and Non-Member Economies. Projections do not assume a significant recovery before the end of 2002, with mostly moderate growth rates from 2003. Average growth rates within the OECD are assumed to be around 3% p.a., while NMEs are expected to grow faster at an average of 4 to 5% p.a. in real terms. A continuation of the particularly strong and robust growth is expected for China at close to 8% p.a. in real terms.

World population growth is expected to increase at 1.2% per year between 2002 and 2007, slightly below the rates observed in the last decade. Most of the population growth will take place in Asia and Africa, while growth in Europe and Oceania is expected to be virtually nil.

Inflation is generally expected to remain low and, in many cases, falling. OECD wide inflation is assumed to average slightly above 2%, while that in China is expected to remain below 5% p.a. Inflation in Russia is projected to fall from the high level recently observed to some 9% in 2007.

Finally, exchange rates are generally assumed to remain constant in real terms (i.e., after taking into account differences in inflation rates) after some adjustments

in the short run. Hence, nominal exchange rates are assumed to follow the lines given by inflation rates: the US Dollar should strengthen further against the Australian and Canadian Dollars, while weakening against the Japanese Yen.

It should be noted that, due to the timing of the Outlook generation, the projections do not take into account the recent developments in the Argentinean and other Latin America countries' economies. Hence, among other issues, the Argentinean Peso is assumed to remain at a constant exchange rate against the US Dollar.

## **2.2 Key policy assumptions**

Next to economic variables, assumptions on agricultural policies are of key importance for the projections. In general, the OECD Agricultural Outlook assumes an unchanged policy environment: existing policies, or those already decided, would continue for the projection period. Full compliance is therefore assumed with existing multilateral and regional agreements, particularly the Uruguay Round Agreement on Agriculture (URAA) and the North American Free Trade Agreement (NAFTA). However, the recent accession of China to the World Trade Organization has not been taken into account.

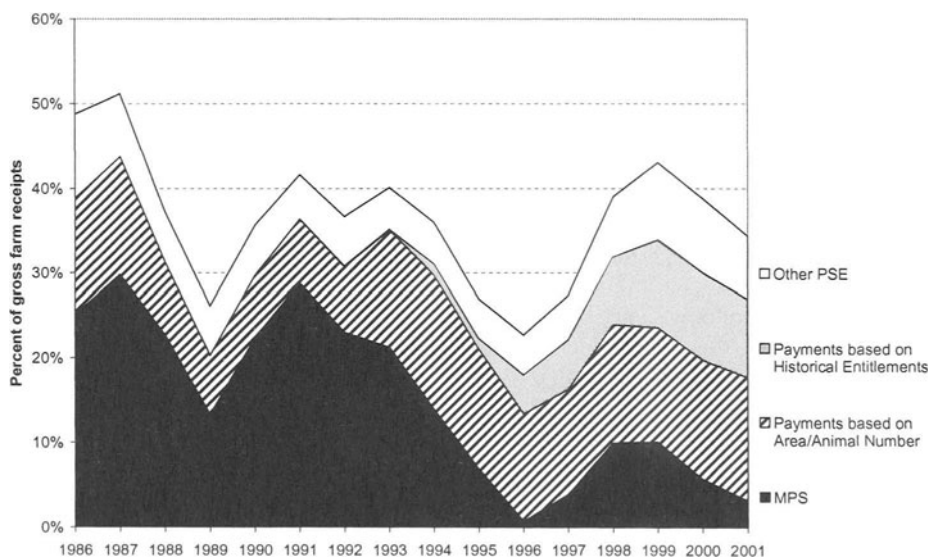
Agricultural policies in the United States and the European Union are of particular importance to the Outlook. For the US, a continuation of the FAIR Act of 1996 is assumed, not taking into account the new Farm Bill signed into law in May 2002. For the EU, a continuation of the 1999 Berlin Agreement is assumed for the projections. Therefore, no change in the policy is taken into account that might follow an eventual decision on the Mid Term Review.

It is worth noting that agricultural support continues to be high in many OECD countries. Figure 18.1 shows the development of total support to OECD grain producers as a share of total gross farm receipts, together with the respective share of market price support, which is known to be highly market and trade distorting (OECD, 2001a). Obviously, while the latter has decreased significantly over the last 15 years, this has been offset to a large degree by payments based on historical entitlements and other measures. Total support for grain producers, expressed as total Producer Support Estimate (PSE) as percent of gross farm receipts, is of similar magnitude as that for the OECD agriculture as a whole, whereas market price support plays a much smaller role in grains than in many other agricultural sectors.



**Figure 18.1**

Support to OECD grain producers (excl. rice) 1986-2001 as percent of gross farm receipts



Note: 'Other PSE' includes payments based on output; input use; input constraints; overall farming income; and miscellaneous payments

Source: Data from OECD (2002b)

## 2.3 Other assumptions

It is important to point out one more area of assumptions, namely those related to weather and other stochastic variables. The Outlook outlined below rests on the assumption of average weather conditions. Therefore, yields are assumed to largely follow their trends observed in the past. Similarly, smooth developments are assumed for most other exogenous variables, such as macroeconomic indicators.

## 3 The outlook for world grain markets

Global cereal markets have seen a considerable weakness in international prices after sharp peaks in the mid-1990s. This weakness has sustained longer than expected, partly because of the fact that producers in some major economies have been shielded from the low international prices, resulting in a limited supply

response to market signals. On the other hand, large stocks have largely buffered the tighter supply-demand balance.

Despite first signs of higher prices, general market conditions are not expected to change dramatically in the medium term. Prices on international markets are projected to rise only slowly in nominal terms. Adjusted for inflation, trade prices for wheat and coarse grains in 2007 should be at similar levels as observed in 2001.<sup>116</sup>

Global wheat production, which averaged some 590 million tons<sup>117</sup> in 1996-2000 but fell to 574 million tons in 2001, is projected to exceed 650 million tons by 2007. This increase in wheat supply will come from both OECD and Non-Member Economies and will be roughly sufficient to keep pace with rising global wheat consumption (see Figure 18.2). Additional wheat supplies would come mostly from increased yields, while area expansion accounts for less than 10% of the additional production quantity. The bumper harvests in Russia and other NIS countries are not expected to be sustained, but 2007 wheat supply in this area should exceed the 1996-2000 average by 16%. While Russia is projected to regularly net import between one and three million tons of wheat, other NIS countries are expected to develop significant export capacities.

World wheat consumption is projected to increase strongly as well and to reach 654 million tons by 2007 – slightly more than produced, thus asking for a slight reduction of global wheat stocks. This gives room for a slow increase in international wheat prices, if only in nominal terms. US export prices for wheat are projected to reach some USD 140 by 2007, growing by an average 1.3% p.a. from 2001. Adjusted for inflation, international wheat prices are projected not to move far away from their 2001 levels.

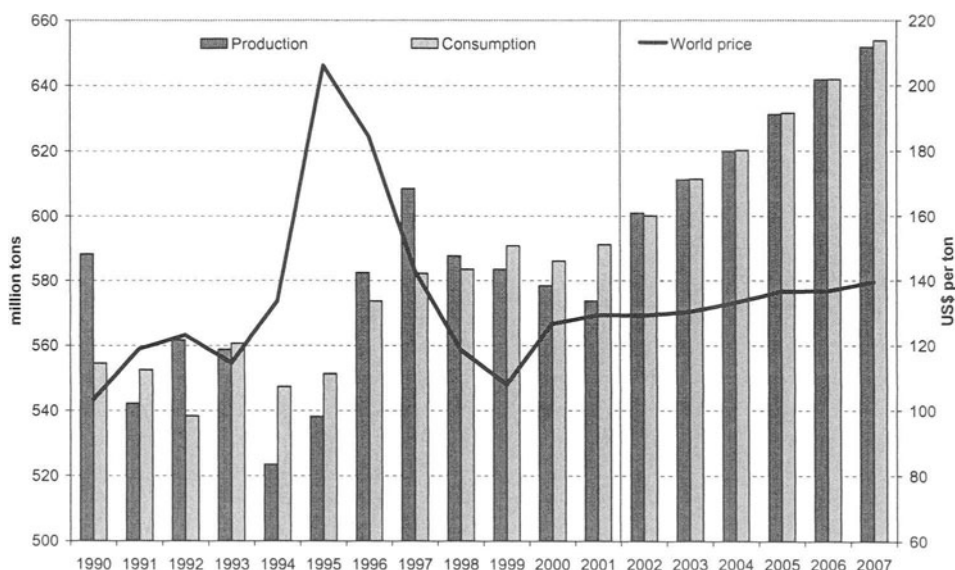
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<sup>116</sup> Market data is given for marketing years. Therefore, e.g. the year 2001 in this paper represents the marketing year 2001/02.

<sup>117</sup> All quantities given in this paper are metric tons.

**Figure 18.2**

Global supply-demand balance of wheat and world wheat prices, 1990-2007



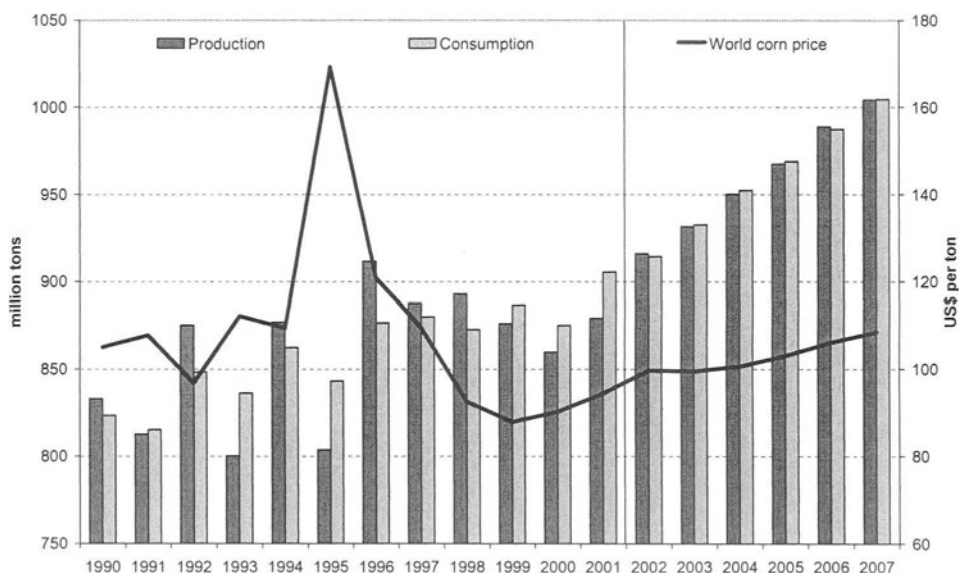
Source: Data and projections from OECD (2002a)

World coarse grains production is projected to increase significantly in the medium term as well. Total harvests, which averaged at 886 million tons annually between 1996 and 2000 with a low in 2000, and rebound to some 880 million tons in 2001, is forecast to exceed one billion tons by 2007 (see Figure 18.3). The majority of this increase will take place outside of the OECD area: China alone accounts for some 33 million tons of additional coarse grains production between 2001 and 2007, and while Russian coarse grain crops would increase by another 3 million tons, the above average harvests of 2001 in the other NIS countries are projected to become normal by 2007. While the rate of productivity growth is similar to that of wheat, some of the additional supply would come also from expanded coarse grain area. This is particularly true for Russia where some of the coarse grain area lost in recent years should be brought back to these crops.

Similar to wheat, global coarse grains production is projected to just keep pace with the increasing consumption, particularly from the growing livestock production in developing countries. Hence, global coarse grains stocks are projected to largely remain unchanged. International prices are expected to recover only slowly from their recent lows: the US export price for corn is projected to remain below USD 110 per ton by 2007, growing by an average of 1.8% p.a. from 2001. In real terms, prices should rise only very moderately.

**Figure 18.3**

Global supply-demand balance of coarse grains and world corn prices, 1990-2007



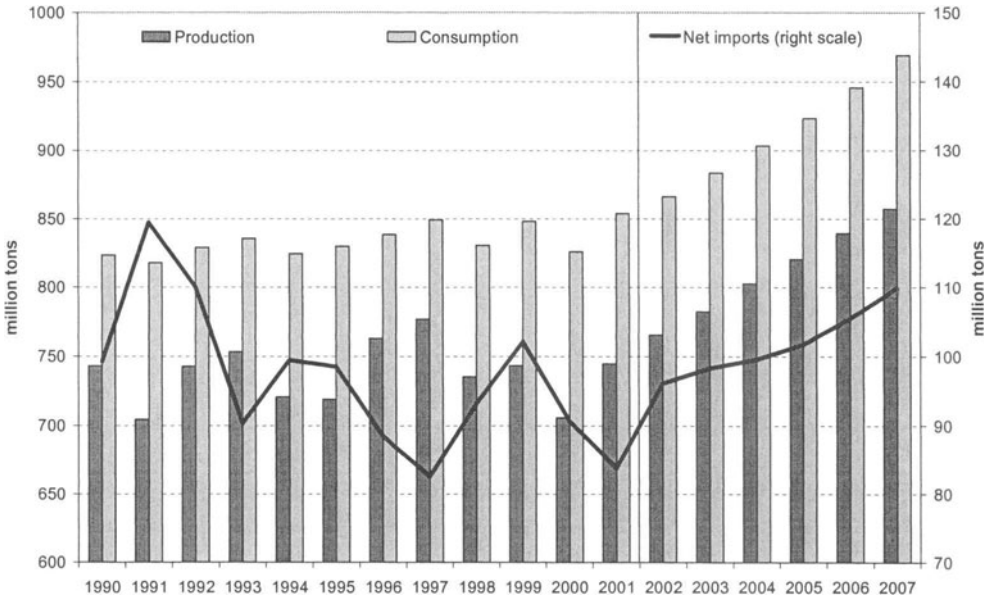
Source: Data and projections from OECD (2002a)

The outlook for the oilseed markets is fairly similar to those for wheat and coarse grains. A stronger increase in international prices is projected only for vegetable oils, which could rise by more than 4% p.a. in nominal terms, which would represent a considerable growth in real terms. This largely reflects the economic growth in some developing countries, which results in rising demand not only for livestock products, but also for vegetable oils. The increasing production of oilseeds in response of this lets little room for increases of oil meal prices, which are projected to start rising even in nominal terms only after 2004.

Despite a significant growth in cereal production, the non-OECD area will remain an important and increasing market for OECD grains. While wheat and coarse grains production in Non-Member Economies should increase by more than 15% between 2001 and 2007, the consumption growth of 13.5% during that period is sufficient to widen the net imports by more than 30%, or 26 million tons, over this projection period. This is not only due to the fact that in absolute terms consumption growth exceeds the production increase by 3 million tons. In particular, the depletion of cereal stocks observed in the recent past is not expected to be sustained in the medium term, thus cutting an important source of cereal supply in some major countries. Net imports to Non-Member Economies are therefore to increase significantly (see Figure 18.4). Despite the significant increase of coarse grain use in the rising livestock sectors, the bulk of the

additional import requirement is projected to be wheat for two reasons. First, wheat represents the major cereal imported from the OECD area – more than two thirds of the aggregate net cereal imports in 2001 where wheat. Second, coarse grains production in many developing countries tends to grow fast enough to keep pace with the rising demand in their livestock sectors.

**Figure 18.4**  
Growing cereal deficit in Non-Member Economies



Source: Data and projections from OECD (2002a)

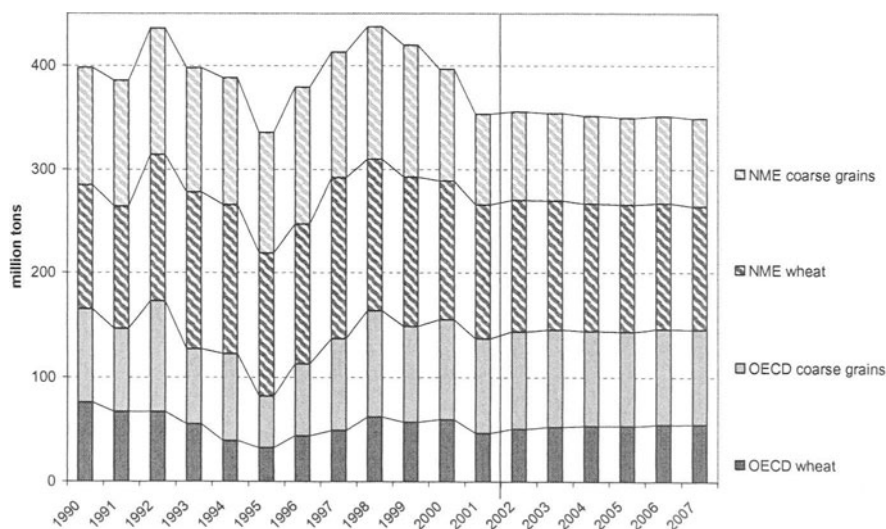
Global cereal stocks have been reduced significantly since 1998 and were at 353 million tons<sup>118</sup> in 2001 (Figure 18.5). Indeed, most of the recent decline took place in developing countries, most notably in China, where wheat and coarse grains stocks have been reduced by 30 and 40 million tons, respectively. In contrast, the low global stocks in the mid-1990s had followed a decline particularly in OECD stockholding, particularly in the United States and the European Union, following changes in their agricultural policies. Projections indicate that cereal stocks within the OECD area should gradually rebuild over the next years, with total stocks in 2007 about 6% above their 2001 levels. Most of the additional stocks would be wheat, with an estimated increase of 17%. This to some degree contrasts with the expected slight decrease in grain stocks outside the OECD: Non-Member

<sup>118</sup> Note that absolute stock levels are subject to considerable uncertainty particularly in developing countries. Data given here are taken from the OECD Aglink database.

Economies are projected to reduce their wheat and coarse grains stocks by some 6% over the outlook period, again with larger changes in wheat than in coarse grains. Therefore, global stocks are not expected to change much over the outlook period.

**Figure 18.5**

Global grain stocks 1990-2007



Source: Data and projections from OECD (2002a)

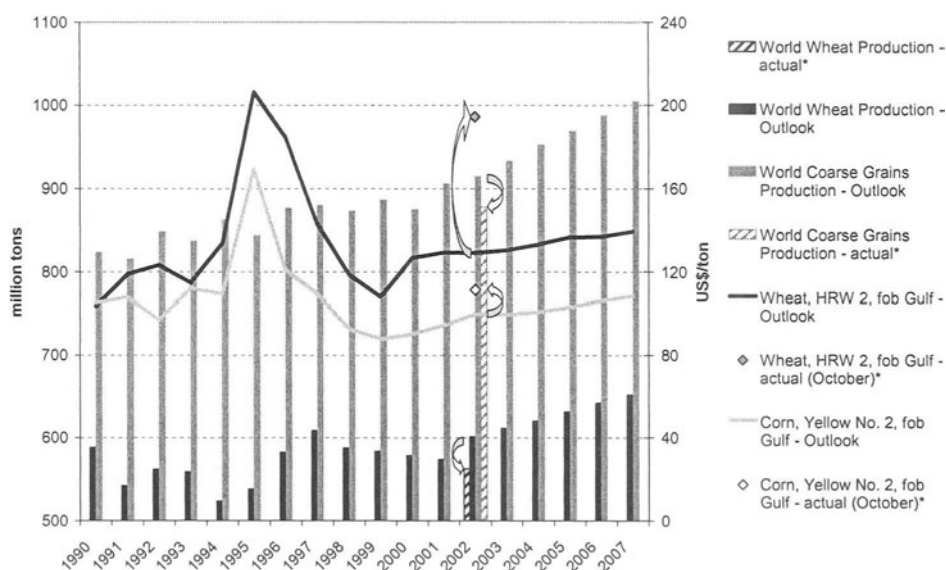
## 4 Recent developments and changes ahead: major amendments in future trends?

As indicated above, the projections outlined in the previous sections rely on a number of assumptions. One of them is the assumptions of smooth developments, due to average weather conditions and smooth paths of macro-economic variables. Given this background, it is worthwhile to look at the most recent developments on international grains markets. Figure 18.6 summarises the current situation on global wheat and coarse grains markets. Currently, world production and price figures suggest that the projections outlined above would be far from reality. Indeed, while projections for global wheat and coarse grains production indicate a robust growth towards 650 million and 1 billion tons in 2007, respectively, the current harvests in the marketing year 2002 are well below the quantities produced in the previous year. In fact, 2002 wheat production is estimated to be only 562 million tons, some 2% below the 2001 figure and more than 6% below the

projection for 2002. Similarly, total coarse grains production in 2002 fell short of the 2001 figure by 3% and are now estimated to be 879 million tons – almost 4% lower than projected. Given the already low grain stocks in many countries, markets now react relatively sensitively to this shortfall, and prices have increased sharply. In October 2002, the US export price for standard wheat (HRW No.2 ord., fob Gulf) reached more than USD 194 per ton, 50% more than projected for 2002 or observed in 2001. Similarly, US export prices for corn (No.2 yellow corn, fob Gulf) increased to more than USD 111 per ton, an increase by 18% compared to the average in the 2001 marketing year and almost 12% higher than projected for 2002.

**Figure 18.6**

World cereal production and prices: projection and recent developments



Source: Data and projections from OECD (2002a) except \*) IGC(2002)

Do these figures indicate a general turnaround in global market trends? Even if global stocks will again suffer from these low production quantities – current estimates by IGC indicate a global stock reduction by another 53 million tons – making world markets even more sensitive in the near future, we argue that these changes should only have small impacts on the medium-term outlook of cereal markets. The majority of the production decline is the direct result from adverse weather conditions in major exporting regions.

**Table 18.5**  
Production shortfalls in major producing regions

Region	Wheat		Year to year change		Coarse grains		Year to year change	
	2001	2002	Mio. t	%	2001	2002	Mio. t	%
Australia	24.0	10.0	-14.0	-58.3	11.6	7.1	-4.5	-38.5
Canada	20.6	15.5	-5.1	-24.8	22.6	19.6	-2.9	-13.0
USA	53.3	44.5	-8.8	-16.5	262.0	244.8	-17.2	-6.6
Argentina	15.5	13.8	-1.7	-11.0	18.2	15.3	-2.9	-16.0

Source: IGC (2002)

Severe droughts result in significant reductions in the grain production of Australia, Canada and the United States (Table 18.5). In Australia alone, wheat output has reduced by 14 million tons, or 58%, compared to the previous harvest. Coarse grains production has been badly affected by the drought as well and will be more than one third below 2001 figures. The United States suffers less in relative terms due to its production volume, but wheat and coarse grains output is cut by 26 million tons compared to the previous year, with corn affected particularly. Similarly, the drought in Canada resulted in eight million tons less grains output. Quite obviously, one would not expect (nor hope) these droughts become a steering factor for future trends.

Not only adverse weather conditions have cut down global cereal output. Argentina, which used to export two thirds of their 15.5 million tons wheat production in 2001, is now facing a severe economic crisis following the floating and devaluation of its Peso. These turbulences result, among other problems, in a 2002/03 wheat and coarse grain crop that is 4.6 million tons below that of last year, a reduction of 14%. In contrast to the weather conditions in the three other regions mentioned, the political and economic situation in Argentina is not likely to improve dramatically over night. However, it seems difficult to assess the implications for agricultural markets and cereal exports, particularly as agricultural policies may react to the crisis (as, for example, a 20% export tax has been<sup>119</sup>).

Apart from these more recent developments, the political and macroeconomic assumptions discussed above are not unlikely to prove wrong. In terms of agricultural policies, next to the recent Chinese accession to WTO and the current Doha Round negotiations, the agricultural policies in the United States and the European Union as two of the main players in cereal markets are of particular interest.

<sup>119</sup> InfoLeg (2002).



The People's Republic of China signed its accession to the World Trade Organization late 2001, committing itself among others to a significant increase of tariff rate quotas for wheat and coarse grains, and a reduction of the power of state trading enterprises that currently control the bulk of Chinese grain trade. While this could lead to some rising grain imports and higher grain consumption in China, previous OECD work (OECD, 2001b) indicates that actual developments may well depend on changes in domestic policies and non-tariff barriers, in parts natural ones such as high domestic transport costs. If the increased import quotas were all filled, Chinese wheat and coarse grains imports would be roughly three million tons per year above the levels projected in the latest OECD Outlook, respectively, allowing for a stronger recovery of international cereal prices.

Current negotiations at the WTO in the context of the Doha Development Round could also result in increased trade volumes and higher prices, if market access is improved and domestic and export support is reduced. As discussed above (Figure 18.1), agricultural producers in OECD countries, including those of cereals, still benefit from high support. However, as support to grain producers today tends to be less coupled to production than it used to be, implications of a further liberalisation of OECD grain markets on global trade and prices are likely to be small. This is even more so as an agreement in the Doha Round is not likely to be achieved easily and quickly, and the resulting changes in actual policies may turn out to be small due to the fact that there is significant water in the bound tariffs resulting of the Uruguay Round Agreement on Agriculture. In other words, it would take a significant reduction of these bound tariffs before actual policies would have to be changed.

The Farm Security and Rural Investment (FSRI) Act has been signed into law by the President of the United States in May 2002 and replaces the existing Federal Agriculture Improvement and Reform (FAIR) Act of 1996 (USDA, 2002). In terms of cereals, the most relevant changes are the following ones: Loan rates for wheat and coarse grains are increased compared to their maximum level under the FAIR Act, and the flexibility of the US administration to set lower loan rates in response to market developments has been withdrawn. New Direct Payments replace the existing AMTA payments, with their levels being higher compared to the former payments. Counter-Cyclical Payments (CCPs) represent a new instrument to replace the Market Assistance Payments paid on an ad hoc basis in recent years. Like the Direct Payments, the CCPs depend on historical crop areas and yields, but in contrast to those payments CCP payment rates would increase with lower market prices and vice versa. Finally, total set-aside under the Conservation Reserve Program is supposed to increase by another 2.8 million acres or 1.1 million hectares. The analysis of possible market implications is not finalised yet and poses significant new difficulties, as the reduction of revenue risk to US farmers is an important direct impact of the FSRI Act (in particular, of the higher loan rates and the new CCPs), modelling of which is a fairly new task. However, preliminary results suggest that US grain production and exports could

be slightly higher and world market prices somewhat lower under the new Bill than under the FAIR Act, particularly in the short run. Much of the impact, however, in turn depends on the developments on international markets, as higher prices would reduce the impact of loan rates and could result in lower CCP rates.

The Common Agricultural Policy (CAP) of the European Union, which was reformed after the Berlin Agreement on the Agenda 2000, is subject to the Mid-Term Review (MTR), a draft of which was proposed by the European Commission in July 2002. Obviously, any changes in the CAP that might result from the MTR are not taken into account in the projections above. A decision on the MTR has not been made yet, and it is unclear when and what will be decided. Up to now, only very rough and preliminary analyses of the MTR proposals have been undertaken, which would indicate that implications on global markets seem to be limited.

More immediate in its implications particularly for Russia and Ukraine, the EU Council adopted a new import system for cereals, following the large imports of low-price grains from the Black Sea region. Wheat and barley imports will be virtually limited to the new quota quantities, as over-quota tariffs are set at high levels of 95 Euro per ton (Agra Europe, 2003). The total import quota for low and medium quality wheat is set at 2.98 million tonnes with subquotas of 0.61 million tonnes for wheat originating in the US and Canada. With over-quota tariffs at prohibitive levels, import quantities should remain largely bound by these numbers. A barley quota is introduced at 0.3 million tonnes for feed, and 50 kilotonnes for malting barley. These import quotas replace the former grain import regime, which was based on variable import duties. As the wheat quotas are relevant only for low and medium wheat, and special sub-quotas are allocated to US and Canadian suppliers, the main impact will be a restriction for Russian and particularly Ukrainian wheat exports to the EU.

In addition, the accession of ten Central and Eastern European Countries (CEECs) to the European Union may have significant implications for the Black Sea region, too. Not only might agricultural policy changes in these countries influence domestic markets, and hence trade, but also could trade with other CEECs be diverted to trade with the current EU members. This again might have significant implications for Russia and Ukraine who historically concentrated on trade with other members of the former Pact of Warsaw.

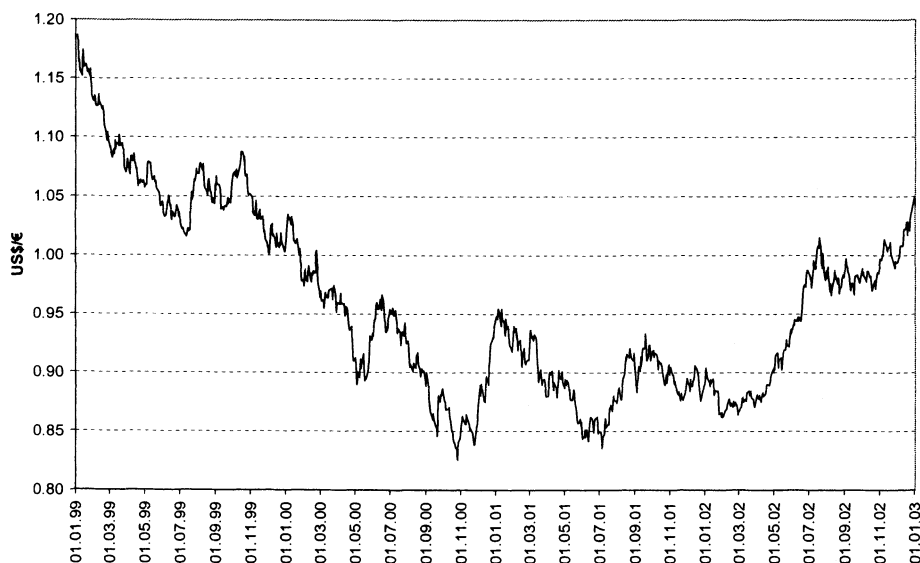
The development of the socioeconomic environment is known to have a significant impact on international markets particularly in the longer run (von Lampe, 1999). However, implications can be relevant in the short and medium term as well, and some of the recent and current developments deserve to be mentioned here.

General macroeconomic assumptions include those on economic growth and exchange rates. Economic growth assumptions have been significantly reduced in the last OECD Agricultural Outlook when compared to the 2001 edition (OECD,

2001c), but current developments suggest that global economic recovery is probably even slower than expected earlier. While the direct impact on grains consumption in developed countries is likely to be small due to low income elasticities, lower income may well reduce meat consumption particularly in less developed countries, which in turn would reduce feed use of cereals. Even more relevant for international grains markets might be the recent development of the exchange rate between the Euro and the US Dollar. Figure 18.7 shows that after a significant decline the exchange rate of the European currency has increased from 0.89 USD/EUR to almost 1.05 USD/EUR within the year 2002, an increase by more than 17%. As outlined in OECD (2002a, p. 30 ff.), a stronger Euro as compared to the US currency tends to result in higher world market prices particularly for wheat and coarse grains, EU exports of which strongly depend on the value of the Euro particularly under low world market price conditions due to the EU limits on subsidised exports.

**Figure 18.7**

Development of the EUR/USD exchange rate, 1999-2002



Source: Data from Bank of Canada (2003)

The financial and economic crisis in Latin America has already been mentioned before. At this point, it should only be noted that the crisis appears to be much deeper, to continue longer, and to affect more countries than anticipated. As some of the countries concerned represent major grain producers and exporters, implications for international cereal markets can be expected to be significant.

Finally, the developments in the CEECs deserve to be briefly discussed as well. Apart from the envisaged enlargement of the EU, recent agricultural growth and market developments in some of the countries have been impressive, notably in Russia and the Ukraine. The rebuild in the respective livestock sectors may play a significant role in the positions that these countries will have in future international grain markets. If crop output continues to recover, but livestock production increase keeps lagging behind, the evolving export capacities may have their impacts on international markets and prices. However, much will depend on a widening and deepening of domestic reforms in these countries.

## 5 Conclusions

World grain prices have been depressed for several years now. While the current market situation would suggest a strong recovery of wheat and coarse grain quotations, much of the recent shortfall in cereal output and the corresponding price increases is more of short term nature rather than a change in long-term trends. The OECD Agricultural Outlook 2002-2007 projects world grain markets to only slowly recover, with little changes in real cereal prices in the medium term. However, changes in the overall economic environment, as well as agricultural policy changes will alter the future market developments, and the recent production shortfalls, though mostly of short term nature, will have their medium-term impacts through significantly reduced global cereal stocks. It can hardly be expected that the high grain prices observed in the mid-1990s would establish to be normal in the next five to ten years, but it seems that the lows of the late 1990s remain exceptional, too.

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# 19 The Implications of WTO-Accession for Ukrainian Agricultural Policy

Stephan von Cramon-Taubadel<sup>120</sup> and Sergiy Zorya<sup>121</sup>

## 1 Introduction

The current focus of attention regarding the WTO in Ukraine is understandably on Ukraine's stated intention to join the WTO, the ongoing negotiations with the Working Party, and the resulting conditions under which Ukraine could be accepted as a member. While we will deal with the agricultural dimension of these questions in this paper, it is important to recognise that the on-going Doha Round of WTO negotiations could also have important implications for agriculture in Ukraine. Ukraine is currently negotiating with the WTO on the basis of agricultural provisions established under the Uruguay Round Agreement on Agriculture (URAA) in 1993. It may be that the result of the Doha Round shifts some of the URAA parameters, creating the need for further adjustment in Ukraine beyond that which would be the result of a successful completion of Ukraine's membership negotiations. Both processes – Ukraine's membership negotiations and the Doha Round – are uncertain as regards both outcome and timing. Hence, at the moment, it is only possible to engage in more or less informed speculation.

Before proceeding, it is useful to reiterate that Ukraine would gain a great deal from WTO membership, in agriculture as in other sectors. The discussion of membership implications in the body of this paper will centre largely on the disciplines and restrictions that will likely result for agriculture and agricultural policy-makers in Ukraine. These disciplines and restrictions will undeniably reduce the freedom or leeway enjoyed by Ukrainian agricultural policy-makers. This might lead some to question the wisdom of WTO membership in the first

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<sup>121</sup> Georg-August University in Göttingen.

place, and for this reason it is important not to lose sight of the benefits that Ukraine will receive in return. These include the following:

- WTO membership would add impetus and urgency to Ukraine's agricultural policy reform agenda, and would also commit Ukraine to a more stable and transparent agricultural policy than has been implemented so far. This would have positive effects on both domestic and foreign investment, something which is of particular importance for a sector that is as capital and know-how intensive as agriculture. As a result, Ukraine, as a WTO member, could tap its agricultural potential faster, to the benefit of the entire economy.
- WTO membership would also give Ukraine a voice in future debates on the international rules governing agricultural trade and policy-making. With its comparative advantage in agriculture and its status as a 'small' country exporter of major temperate agricultural products such as grains and oilseeds (and potentially livestock products), Ukraine appears predestined to become a member of the Cairns group. Like the Cairns group members, Ukraine desperately needs a level playing field in international agricultural trade. It was the Cairns group's insistence in the Uruguay Round that led to the first substantive agricultural agreement in the history of the (GATT-) WTO, and many are pinning their hopes on similar advocacy by the Cairns group in the Doha Round.<sup>122</sup>
- Finally, as a WTO member, Ukraine would enjoy access to the WTO's dispute settlement mechanism and protection from arbitrary treatment by its trading partners. That this can be of great importance has been demonstrated recently in connection with the EU's decision to introduce grain import quotas. While the EU had to consult with other WTO members – such as Canada and the United States – on this matter, it did not have to consult with Ukraine.<sup>123</sup>

In the following we begin by briefly outlining the relationship between agriculture and the WTO (Section 2), before proceeding to consider the likely impact of WTO

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<sup>122</sup> This voice could become especially important if the so-called 'Peace Clause' agreed to under the WTO and due to expire on January 1, 2004 is not renewed. The Peace Clause protects important aspects of current agricultural policies – especially in the EU and the US – from challenge. Should it expire, some experts feel that other WTO members could mount a serious challenge against the world's major agricultural subsidisers (Agra Europe, 2002, p. EP/12).

<sup>123</sup> It should be noted in passing that the EU's decision to impose grain import quotas is unfortunate and not in the spirit of a progressive liberalisation of world agricultural trade. Indeed, it borders on hypocritical when firms in the EU lobby for the opening of Ukraine's markets for agricultural machinery and other farm inputs, while the EU simultaneously restricts its own markets for the grains that these inputs are used to produce.

membership on agriculture and agricultural policy-making in Ukraine (Section 3). We close in section 4 with conclusions and a brief look forward.

## 2 The WTO and agriculture

Agriculture has a special place within the WTO largely because it is spent most of the history of this organisation – and its predecessor, the GATT – without. As mentioned above, the Uruguay Round marked a turning point in that, largely as result of the insistence of the Cairns group, agriculture was for the first time subjected to meaningful disciplines. While the subjection of agriculture to international rules governing trade without doubt represented a major breakthrough, in retrospect the concrete impact of the URAA on domestic agricultural policies in the member countries has been rather disappointing. As illustrated in Figure 19.1, for example, there has been some reduction in overall agricultural support in the OECD since the mid-1980s.<sup>124</sup> Since the mid-1990s, however, no clear trend is apparent. As a matter of fact, in the United States agricultural support is on the rise.

With high insight it is clear that the URAA contained too many loopholes, for example in the form of base period definitions that were designed to leave as much leeway as possible, or commitments to reduce support or import protection that could be applied on average, leaving considerable discretion to maintain 'peaks'.<sup>125</sup> As a result, agricultural support in the OECD as a whole in 2001 amounted to a staggering EUR 258 bn or roughly 1% of total OECD GDP. As is apparent in Figure 19.2, the EU and the USA are responsible for the lion's share of this support.

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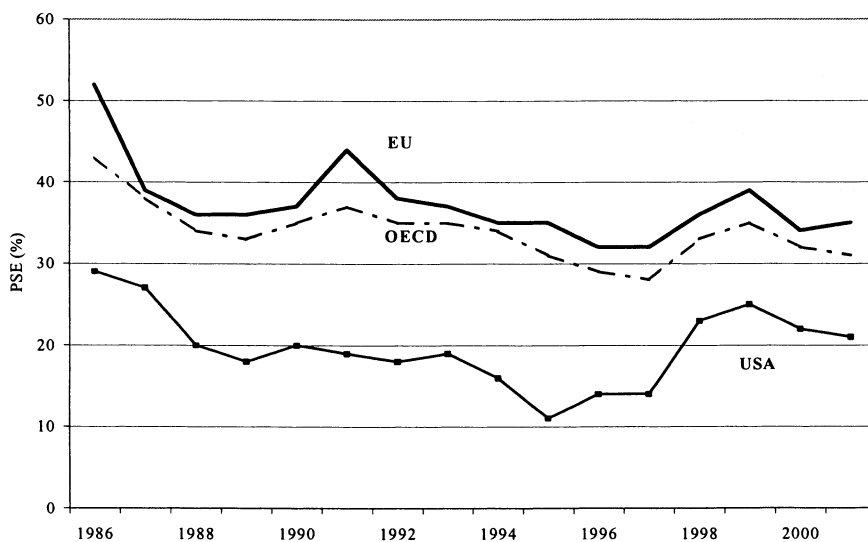
<sup>124</sup> Agricultural support is measured in Figure 19.1 using the Producer Subsidy Equivalent (PSE) concept developed by the OECD. The PSE measures support to farmers, from consumers through higher commodity prices and from taxpayers through budgetary transfers. The PSE is defined as the annual value of the total monetary transfers from consumers and taxpayers to agricultural producers as a percentage of gross farm receipts (OECD, 2000).

<sup>125</sup> Many of these aspects of the URAA are discussed in detail in the Chapter 17 by Gaisford and Kerr included in this volume.



**Figure 19.1**

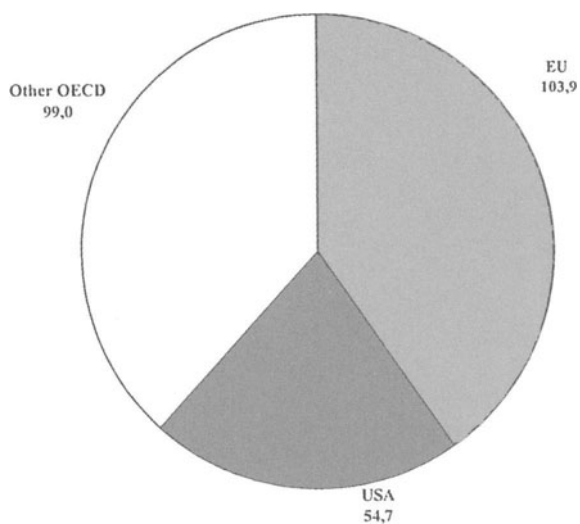
Agricultural support in the OECD, 1986-2001, % PSE



Source: Tangermann (2002)

**Figure 19.2**

Agricultural support in OECD countries, 2001, EUR bn

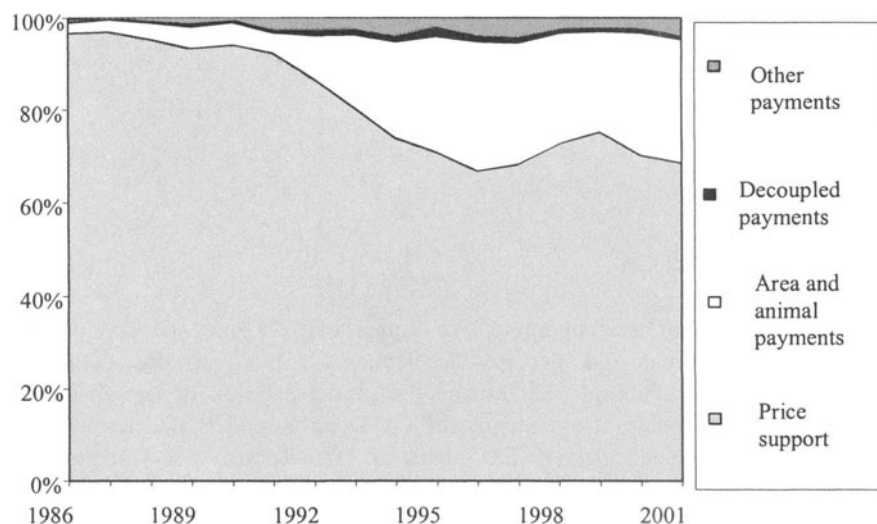


Source: Tangermann (2002)

In view of these agricultural policies elsewhere, it is easy to empathise with the position of Ukraine's negotiators with the WTO, who must at times feel as if they are being subjected to a double standard: "Don't do as we do; do as we say". Nevertheless, it is important not to draw the wrong conclusions from a Ukrainian perspective regarding the desirability of agricultural protection and support. First, as the numbers in Figure 19.2 illustrate, agricultural support is very expensive. While it might benefit farmers, it places a significant burden on taxpayers and/or consumers. When support takes the form of protection (for example price support or production quota systems) it leads to economic waste, reducing economic growth and destroying jobs. It is moot whether 'rich' countries such as the EU can actually afford these costs; it is abundantly clear that Ukraine cannot.

**Figure 19.3**

The structure of agricultural support in the EU, 1986-2001



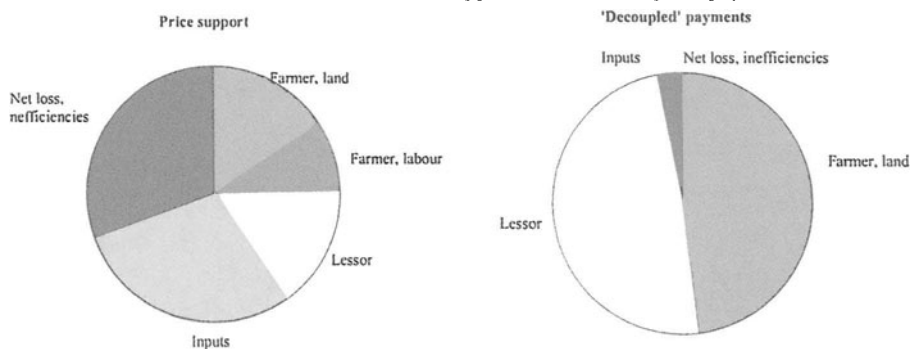
Source: Tangermann (2002).

Second, note that while agricultural support in the OECD countries has not fallen much on average since the end of the Uruguay Round, the structure of agricultural support has been changing. As illustrated in Figure 19.3, the importance of price support has fallen progressively in the EU since the early 1990s, while the importance of various forms of direct payment has increased. This is important because, again, different types of agricultural support are associated with different degrees of efficiency. As illustrated in Figure 19.4, only roughly 40% of price support payments end up in farmers' or land owners' pockets – the remaining 60% end up either wasted or in the hands of input suppliers. Decoupled payments are considerably more efficient as roughly 90% end up benefiting farmers. Hence, while agricultural support remains prevalent, there is a clear trend to more efficient forms of support. The recent so-called Mid-Term Review (MTR) reform

proposals tabled by EU agricultural Commissioner Fischler – with their emphasis on further reduction in price support and a move to decoupled income transfers – are symptomatic of this trend. Ukraine would be well advised to anticipate the results of this trend and design an agricultural policy that is forward looking and does not force Ukraine to repeat the costly mistakes that have created so much domestic and international friction elsewhere.

**Figure 19.4**

Who benefits from agricultural policy? Price support versus 'decoupled' payments



Source: Tangermann (2002)

Third, the results of the ongoing Doha Round of WTO negotiations can be expected to continue and perhaps accelerate the trend toward continued liberalisation of agricultural policies and the implementation of less distortive policy tools world-wide. The outcome of the Doha Round is uncertain at the moment,<sup>126</sup> and some analysts are sceptical that it will lead to major a breakthrough in agriculture because two major players – the EU and the US – both appear to be considerably less than fervent in their desire for reform. The agricultural proposals that are currently on the table in the Doha Round and the prospects for a successful outcome of this round are discussed elsewhere in this book in great detail and clarity and need not be repeated here.<sup>127</sup> Certainly, experience with the implementation of the URAA has made it clear where the loopholes are and how they might be plugged. Whatever the exact outcome of the

<sup>126</sup> The first draft of an outline agreement on agricultural subsidies was tabled by the Chairman of the WTO agricultural negotiations on December 18, 2002. According to schedule, the WTO members should agree on the so-called 'modalities' (a framework that specifies the percentage and other support and protection reductions that will emerge from the Doha Round) by March 31, 2003. After the 'modalities' have been established, member countries will make corresponding detailed offers on how they propose to reduced their domestic support and protection measures (Agra Europe, 2002, p. EP/8).

<sup>127</sup> See the Chapter 17 by Gaisford and Kerr in this volume.

Doha Round, a return to the policies of the 1960s-1980s, with their emphasis on price support, is out of the question. So, again, Ukrainian policy-makers should look forward and not back in their search for '*Leitbilder*'. Any progress in the area of agriculture as a result of the Doha Round would benefit Ukraine. In particular, a reduction in the use of export subsidies – which both the Cairns group and the US have made a central element of their negotiation proposals – would make it easier for Ukraine to compete on world markets.

### 3 The implications of WTO membership for Ukrainian agriculture

The URAA contained provisions in four major areas related to agriculture. These are: market access; domestic support; export subsidies; and sanitary and phytosanitary measures. These categories are also framing the current Doha Round negotiations on agriculture, so it makes sense to structure the following discussion along these lines as well.

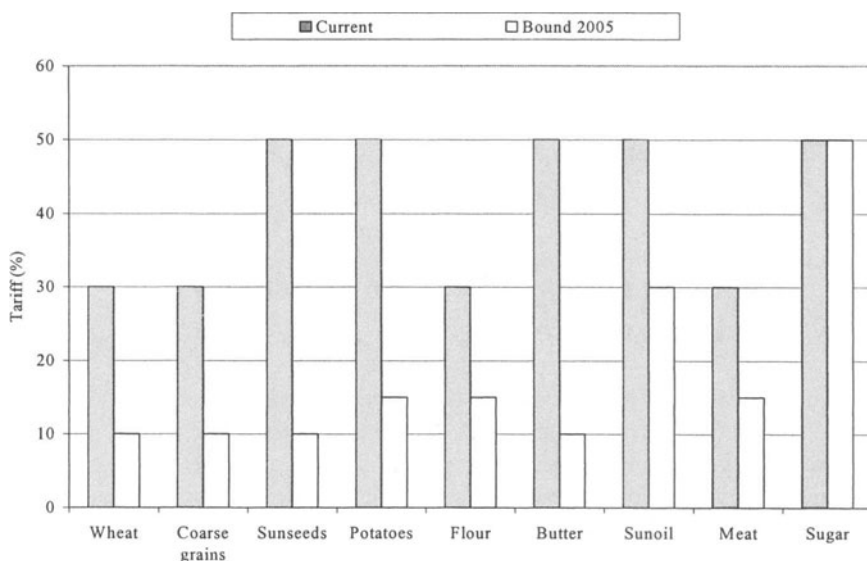
#### 3.1 Market access

As the outcome of the negotiations between Ukraine and the member countries of Ukraine's WTO working party are ongoing, it is not yet clear exactly what concessions Ukraine will have to make in the area of market access. Ukraine has offered to reduce its tariffs on major agricultural products from the current levels illustrated in Figure 19.5 to the bound levels also presented in this Figure. This would reduce Ukrainian agricultural tariffs roughly from 22% to 13% on average, and there are indications that the members of the working party are more or less in agreement with this proposal.

Membership in the WTO would also entail that the not infrequent use of specific agricultural tariffs in Ukraine would have to be curtailed in favour of *ad valorem* tariffs. Furthermore, it appears that Ukraine would not be permitted to make use of special safeguard provisions. Special safeguard provisions were introduced at the end of the Uruguay Round as a means of providing countries such as the EU – that were required to transform variable import levies and other non-tariff barriers to trade into bound tariffs – with a means of dealing with the import surges that might result. Since Ukraine makes no use of such non-tariff import barriers, it will not be required to subject them to 'tariffication' as a result of WTO membership and will therefore be in no greater danger of import surges after the fact than it was before.

**Figure 19.5**

Current and committed bound agricultural import tariffs in Ukraine



Source: Own presentation based on Government Decree on Unified Customs Tariff in Ukraine from 1993, Presidential Decree on Transformation of Unified Import Tariff in Accordance with the GATT/WTO from 1996 and law of Ukraine on State Regulation of Agricultural Imports to Ukraine from 1997 (see on [www.rada.kiev.ua](http://www.rada.kiev.ua)).

A contentious area with regard to market access is sugar. As can be seen in Figure 19.5, sugar is the one important agricultural product for which Ukraine has offered no tariff concessions. Ukraine is a net importer of sugar, so controlling imports is, together with the domestic production quotas that have been implemented, a means of controlling domestic prices.<sup>128</sup> The size of Ukraine's tariff rate quota for imports of raw sugar has been an issue of some contention with different members of the working party; amounts of 200 000 tons and 260 000 tons have been discussed. As the Ukrainian authorities have discovered, and as was predicted several years ago by the German Advisory Group (von Cramon-Taubadel, 1999), Ukraine's sugar policy has generated considerable incentives for smuggling, so that the size of the tariff rate quota may be at least partly academic. Unfortunately, sugar would appear to be one area of agricultural policy in which Ukraine is insisting on repeating the costly errors committed elsewhere.

The net effect of all of these market access provisions on agriculture in Ukraine is difficult to predict. To date, there is no modelling tool available that provides the

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As a result of production quotas and import barriers, domestic prices for white sugar in Ukraine have ranged between 2 000 and 2 200 UAH/t in recent months, the equivalent of 375 to 410 USD/t or roughly twice the world market price.

detailed depiction of cross-product linkages (i.e. between the livestock sector and the grain sector, or between different varieties of grain) that would be required to provide a detailed set of simulations. The *German Advisory Group* and the affiliated *Institute for Economic Research* have begun to develop such a modelling tool and hope to be in a position to provide first results by end-2003. However, the required data basis, especially as regards supply side responses, remains fragmentary and the prevalence of the shadow economy and activities such as smuggling will continue to challenge modellers for years to come.

### 3.2 Domestic support

The area of domestic support is perhaps one of the most controversial areas in the negotiations between Ukraine and the members of its WTO working party. Ukraine has proposed that a 1994 to 1996 base period be employed to define Ukraine's bound level of domestic support. The use of this base period leads to an aggregate measure of support (AMS) of USD 1.38 bn. Some members of the working party are, however, insisting on the use of a 1997 to 1999 base period that would leave Ukraine with an AMS of USD 0.64 bn. Ukrainian officials argue that USD 1.38 bn is already a very small amount compared with the support that other countries – in particular the EU and the US – provide to their agricultural sectors (recall Figure 19.2 above). They also argue that the use of 1997 to 1999 – the depth of Ukraine's agricultural crisis – is not at all representative and would limit Ukraine to a level of support that is not in keeping with the agricultural policy needs of such a large and important sector of the Ukrainian economy. Some working party members are insisting, however, that any amount of agricultural support is simply too much, and that Ukrainian agriculture should not be permitted to become addicted to subsidies in the first place. These countries – for example Australia<sup>129</sup> – are concerned that without strict WTO disciplines Ukraine would end up joining the ranks of those competitors that use subsidies to compete unfairly on world agricultural markets.

Ukrainian negotiators might be forgiven for feeling that the strict demands on Ukraine's AMS level that some members of the working party are making are at least partly the result of frustration born from their inability to apply meaningful pressure to the much larger and much more trade distorting domestic support provided by the US and the EU. On the other hand, note that Ukraine provides the majority of its domestic support (roughly 80%) in the form of tax exemptions that are not included in AMS calculations.<sup>130</sup> Hence, the debate over 1.38 *versus* USD 0.64 bn of domestic support is to some extent artificial in that regardless of the amount that is finally bound, tax exemptions will continue to provide a means of

<sup>129</sup> Note that Australia's agricultural policy is very liberal in comparison with other OECD members. Its PSE currently amounts to 4% or USD 1 bn (Tangermann, 2002).

<sup>130</sup> See von Cramon-Taubadel and Zorya (2001).

delivering more support. Note as well that USD 1.38 bn or the equivalent amount of Hryvnia (roughly 7.4 bn) is far in excess of any amount that could realistically be incorporated into Ukraine's state budget in the foreseeable future. For these reasons Ukraine would be ill advised to allow the success of its WTO negotiations to hinge on the domestic support issue. Indeed, from an economic perspective, Ukraine would be well advised to ensure that whatever agricultural policy tools it implements are largely green box measures – such as support for education and research in agriculture and the development of agricultural marketing infrastructure – that would not be subject to domestic support disciplines in the first place.

### **3.3 Export subsidisation**

As Ukraine has not employed export subsidies in the past it follows – and would appear to have been accepted by all parties to the negotiations – that Ukraine should receive no allowance for the use of export subsidies in the future. Since it is not unlikely that the Doha Round will lead to a major curtailment and perhaps even the elimination of the use of export subsidies in agriculture, it would probably not make much sense for Ukraine to insist – as Russia currently is – on receiving an export subsidisation allowance; the 'bargaining chips' that would be required to gain concessions in this area are better employed elsewhere.

An important implication of the fact that Ukraine would not be permitted to use export subsidies as a future WTO member is that as a net exporter of most important agricultural products, Ukraine would not be able to employ domestic price support measures. This is because domestic price support in an export situation necessarily leads to the accumulation of surpluses that can only be exported with the use of some form of export subsidy, either implicit or explicit. This means, for example, that the intervention system for grain that Ukraine introduced in the summer of 2002 is fundamentally incompatible with the likely conditions of Ukraine's WTO membership. WTO membership would therefore result in a considerable reduction in the range of policy tools available to agricultural policy-makers in Ukraine. From an economic efficiency perspective this would be a positive development as it would preclude the use of inefficient and distortive price support policies (recall the discussion surrounding Figure 19.4 above). By joining the WTO, agricultural policy-makers in Ukraine would in effect be committing themselves to resist the temptation to use these tools in the future.

### **3.4 Sanitary and phytosanitary measures**

The agreement on sanitary and phytosanitary (SPS) measures reached at the end of the Uruguay Round aims to reduce trade tensions by limiting the use of health and

safety measures that are disguised protection. The SPS agreement, which is described in greater detail by Schuler (Chapter 1), aims to harmonise the SPS measures applied by WTO member countries and ensure that they are both transparent and science-based.

As the procedures used to test for contamination become increasingly sophisticated and sensitive, and as consumers in industrialised countries become increasingly sensitised to food quality issues, there has been some concern that SPS measures could lead to a 'race to the top' whereby industrialised countries set very exacting standards that are prohibitively expensive to control and monitor in 'small' countries that cannot afford to invest in the required capacities (for example, personnel and laboratories). The result could be non-tariff barriers in the guise of consumer protection.<sup>131</sup>

For this reason, 'small' countries such as Ukraine have a strong interest in an SPS agreement that ensures transparency and fairness. At the same time, Ukraine should take every possible step to ensure that problems with the quality of its own food exports do not fuel a demand for excessive SPS standards in other countries. As recent alleged findings of various types of contamination in shipments of Ukrainian grain to Brazil, France and Canada attest, the issue of product quality and the SPS measures employed to control this quality is already of vital importance to Ukraine.<sup>132</sup> While the costs of developing the required SPS infrastructure in Ukraine are high,<sup>133</sup> they are actually fairly small in comparison to the potential economic value of agricultural trade to the Ukrainian economy. Furthermore, investments in developing this capacity would fall into the green box category of agricultural support measures; they would represent vital support for the development of Ukrainian agriculture that is not subject to WTO disciplines. Moreover, there is considerable multilateral and bilateral international aid available to countries such as Ukraine for the development of SPS capacity.

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<sup>131</sup> See Josling (2002) for a discussion of some of these issues. Josling reports that so far the evidence on the use of the SPS dispute settlement mechanism by smaller economies is not encouraging. He reports on 69 cases that have been raised so far by small economies. Of these, roughly two thirds were raised against OECD countries. In only roughly 20% of these 69 cases did the small economy reach its objectives. He suggests that small economies should make use of joint representation to pool scarce resources, and that funds be made available to small economies to help them both adopt SPS measures and, when necessary, initiate SPS disputes.

<sup>132</sup> See von Cramon-Taubadel, S. (2002).

<sup>133</sup> See the evidence on the costs of the required investments in Schuler's chapter in this volume.



## 4 Conclusions

Experience in many countries has shown that agricultural policy-making is fraught with difficulties. Agricultural interests – farmers, landowners and input suppliers – tend to be well organised and ‘capture’ the policy-making process. As a result, agricultural policy tends to be both very wasteful and very resistant to reform. Experience, for example in the EU or New Zealand, has also shown that when agricultural policy reform does occur, it is not because agricultural policy-makers have suddenly ‘seen the light’. Instead, agricultural policy reform is almost always imposed from without, for example by strapped budgets or by the need to meet international commitments. The WTO is one source of such international commitments. While the results of the Uruguay Round breakthrough on agriculture have been somewhat disappointing in retrospect, this breakthrough did at least bring agriculture to the table and initiate a discernable trend towards less distorting forms of agricultural support worldwide.

An agreement on Ukrainian membership in the WTO is within reach. The likely agricultural conditions of WTO membership for Ukraine would not appear to be very onerous. Some liberalisation and market opening would result, but Ukrainian agriculture is only beginning to emerge from the transition crisis of the 1990s and agricultural policy in Ukraine is only beginning to take on clear contours. Hence, much is in flux and could be adapted with relative ease. It is much more difficult to change agricultural policy once it, and those who benefit from it, become firmly entrenched. If only for this reason, Ukraine should welcome WTO membership and make every effort to secure it quickly. The requirement that Ukraine would have to abstain from employing export subsidies as a WTO member would have especially far-reaching consequences in this regard; it would preclude the use of price support policies for agricultural products that Ukraine exports. This is just one of the ways in which WTO membership could help Ukraine avoid the agricultural policy mistakes that have proven so costly and difficult to repair elsewhere.

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